Supreme Court, U. S.
FILED
OCT 18 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76- 76-541

MAX GRENADER *et al.*,

Petitioners,

v.

MILTON SPITZ *et al.*,

Respondents,

and

BERNARD COOPER *et al.*,

Additional Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Additional Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, Max Grenader, Roger W. Ach II, Ann Fielder, John Gerstad, Lee Gerstad, Celia Gordon, P. Benjamin Kaufman, Dorothy Kimball, Gertrude Landau, Horace Mills, Adrienne Minassian, Sylvia Jane Morrison, Cora Muller-Thym, H. Victor Schwimmer, Frances Stein, Marion Terres, John Terres, Masie G. Wilkinson and Olga Rudnyansky, respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit which reversed an order of the United States District Court for

the Southern District of New York and dismissed the complaint for lack of subject matter jurisdiction*.

In an unprecedented decision going directly against the latest decision of this Court on the subject and the unanimous line of prior legal authority, the Second Circuit has removed from the protection of the federal securities laws purchasers of stock in all types of cooperative housing corporations, regardless of whether they purchase with a view toward resale at a profit and regardless of any resemblance between such corporations and conventional business corporations. Previously, in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), which was explicitly confined to stock of a publicly sponsored and subsidized, non-profit cooperative housing corporation (Co-op City), this present Court had held in unmistakable terms that such stock was not a "security" under the federal securities laws only because of the total absence of any possibility of profit arising from its purchase and of various differences between the corporation there involved and conventional business corporations. The Second Circuit - supposedly on the basis of *Forman* - has now held that stock in a privately

*Petitioners are plaintiffs in the action in which this Writ of Certiorari is sought. Plaintiffs originally included P. Benjamin Kaufman, who has since died without being substituted by his legal representative although such substitution is intended. They also included Madeline Schainuck, who has withdrawn from the action. In addition to Milton Spitz, respondents are Henry Spitz and Jerome Spitz, all d/b/a Three Forty Five Management Co., and 34557 Corp. (sued herein as "34557 Tenants Corp") In addition to Bernard Cooper, the additional respondents are Robert Julius, Jerry V. Shields, Jr., William L. Livingstone, Joel Key Rice, Frank Moorman, Judith Ann Taft, Gloria Lister a/k/a Gloria Hahn, Sylvia Spitz, Ernest Borkland, James Daniel Cotton, Bobby Mitchel and S. Mercer Moorman, who also died during the pendency of this action.

sponsored cooperative housing corporation, with respect to which there are substantial incentives and possibilities of profit, is not such a "security", and this even though the differences from conventional business corporations alluded to in *Forman* are absent and resemblances to such corporations exist to a marked degree. Despite the criteria of *Forman*, the Second Circuit has now held that purchasers of such stock are deprived of protection under the 1933 Securities Act and the 1934 Securities Exchange Act.

The decision is of fundamental importance in regard to cooperative apartments which are now being offered for sale and sold in large numbers throughout the country and which constitute the living accommodations occupied by approximately one million people*. Widespread fraud and unfair dealing in the sale of interests in cooperative houding corporations, the inadequacies of remedies under State law and opportunities which cooperatives afford for circumventing rent controls emphasize the need for regulation under the federal

*The Bureau of the Census indicates that in 1970 there were a total of 416,094 occupied cooperative and condominium housing units in which the median number of persons per unit was 2.1. U.S. Department of Commerce, Social and Economic Statistics Administration, Bureau of the Census, Subject Reports, Cooperative and Condominium Housing, Table A-2, p. 2. Nearly 85% or 351,000 of these housing units were cooperatives. I HUD Condominium Cooperative Study, pp. III-12, 13. From 1970-1974, 70,000 new cooperative housing units were built; there were 25,000 conversions; and 7,000 cooperative housing units were removed. As of April 1, 1975, there were a total of 439,000 cooperative housing units throughout the country. Id., p. III-13. Most were in New York, California, Florida, Illinois, Michigan, New Jersey and Pennsylvania. Id., p. III-7. Assuming the same median number of persons per unit as in 1970, there were 439,000 x 2.1 or 921,000 persons occupying cooperatives as of April 1, 1975. These were mainly in urban areas and privately sponsored. Id., pp. III-43, 60.

securities laws*, which have heretofore been regarded as the desirable and logical means for affording protection, at least to purchasers of stock in privately sponsored cooperative housing corporations. Despite these considerations, the decision of the Second Circuit (i) misconceives and unwarrantably extends the scope and effect of *Forman* so as to exclude from the protection of the federal securities laws shareholders in *all* types of cooperative housing corporations, whether privately sponsored and profit-oriented or of the *Forman* type involving publicly assisted, non-profit cooperatives, thereby causing confusion and uncertainty as to the Congressional intent underlying the securities laws and their construction by the Securities and Exchange Commission; (ii) improperly applies the tests for a "security" enunciated in *Forman* and other authorities, and undermines definitions of "stock" and "investment contract" established by this Court and the Circuit Courts for many years; (iii) fails to give effect to statutory saving clauses in the federal securities laws whereby Congress intended to protect such shareholders by providing a federal forum for relief from violations of the securities laws; (iv) reverses on improper grounds the previous law of the Second Circuit (established by another panel) in *1050 Tenants Corp.* v. *Jakobson*, 503 F.2d 1375 (1974),whereby stock in privately sponsored cooperative housing corporations which could be resold at a profit had been deemed a "security"; and (v) creates troublesome conflicts and problems of construction respecting the Rules and policies of the SEC.

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*I HUD Condominium Cooperative Study, V-4, 8, 12, 36-39, 48; Cooperative Housing Corporations and The Federal Securities Laws, Col. L. Rev., Jan. 1971, 118, 123, 139.

Opinions Below

The opinion of the Court of Appeals is reported at 537 F.2d 612 and is set forth in Appendix A. Its orders denying a petition for a rehearing en banc are not yet reported but are also set forth in Appendix A*. The opinion of the District Court on petitioners' original motion is reported at 390 F.Supp. 112 (SDNY 1975). Its opinion on renewal and reargument is not officially reported. Both of these opinions are set forth in Appendix B.

Jurisdiction of This Court

The judgment sought to be reviewed was entered on April 28, 1976 and is set forth in Appendix C. The petition for rehearing was denied on July 20, 1976. The jurisdiction of this Court is invoked under 28 U.S.C.§1254(1).

Questions Presented

1. Is stock in a privately sponsored cooperative housing corporation a "security" within the purview of the 1933 Securities Act and the 1934 Securities Exchange Act, particularly when it arises out of the following circumstances:

a. It may appreciate in value and be resold at a profit;

b. Dividends may be declared thereon;

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*References to the appendices are prefaced with the appendix letter followed by the page number, e.g. (A3).

c. Its purchase is accompanied by profit incentives evidenced by the buyers' efforts to resell it at substantial profits immediately or shortly after its purchase;

d. The corporation resembles conventional business corporations in the very respects which this Court deemed important in *Forman*.

2. Does this Court's decision in *Forman* overrule the law of the Second Circuit embodied in *Jakobson* and, if not, should the Second Circuit have reversed *Jakobson* in view of the saving clauses in the federal securities laws?

Statutes and Rules involved

This case involves §§2(1),(2),(4), 3(a)(11), 5, 12, 15, 17, 22(a), 24 and 26 of the Securities Act of 1933 (15 U.S.C. §§77b(1), (2), (4), 77c(a)(11), 77e, 77l, 77o, 77q, 77v(a), 77x, 77z); §§3(a)(8), (10), (13), 10(b), 15, 20, 27, 29(b) and 33 of the Securities Exchange Act of 1934, 15 U.S.C. §§78c(8), (10),(13), 78j(b), 78o, 78t, 78aa, 78cc(b) and 78gg); Rule 235, General Rules and Regulations under the Securities Act of 1933, 17 C.F.R. 230.235; Rules 10b-5, 15a-2, General Rules and Regulations Under the Securities Exchange Act of 1934, 17 C.F.R. 240.10b-5, 240.15a-2; New York General Business Law, §352-e; New York City Rent Control Regulations §55; New York City Rent Stabilization Code, §61; New York Business Corporation Law §510; and Rule 54(b) and (c) Federal Rules of Civil Procedure, the texts of which are set forth in pertinent part in Appendix D.

Statement of the Case

The District Court's jurisdiction of this case was invoked under §22 of the 1933 Securities Act(15 U.S.C. §77v) and §27 of the 1934 Securities Exchange Ace (15 U.S.C. §78aa.) (D7, 12).

The case involves corporate stock which can be purchased and resold at a substantial profit and which on various occasions has been resold at such a profit. The stock is that of respondent 34557 Corp., a corporation formed pursuant to a conventional, i.e., a privately sponsored, non-publicly assisted, plan to convert to cooperative status a 59-family apartment house in New York City.

Petitioners are tenants of 17 of its apartments, two of whom, Ann Fielder and Sylvia Jane Morrison, have purchased stock offered under the plan, the remaining petitioners having unexpired contractual rights to make such purchases*.

The building previously belonged to respondent, Three Forty Five Management Co., a partnership consisting of four brothers, the respondents, Milton Spitz, Henry Spitz and Jerome Spitz, and Edward M. Spitz**. In 1971, after

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*Under certain conditions less favorable than those initially available, such tenants are to retain the right to purchase.

**The Spitz brothers were partners in their capacities as trustees for the benefit of their mother, Minnie Spitz, and one of the brothers, Jerome Spitz, was also a partner in his individual capacity. Minnie Spitz died on August 18, 1971. During the cooperative conversion here involved, the trust was being wound up. Edward Spitz died during the pendency of the action.

organizing 34557 Corp. under the New York Business Corporation Law, the partnership filed an offering statement or prospectus in the New York State Attorney General's office and presented it to the tenants. Under the offering, predetermined quantities of the corporate stock were allocated to the tenants' apartments and offered to them for sale at prices fixed by the partnership. The proceeds were to be used by the corporation to purchase the building from the partnership at a price fixed by the latter.

At the time of the offering, the tenants' right to continue to live in their apartments was protected by the rent control laws whereby they might continue in occupancy as long as they paid the required rents and as long as 35% of the tenants of rent controlled apartments refrained from subscribing to the purchase of the stock within 6 months from the date of the offering*.

Purchasing tenants were to have the right to enter into long-term leases of their apartments. Non-purchasers were to be subject to eviction by other persons who might purchase the stock allocated to their apartments**.

On June 6, 1972, claiming that the required subscriptions had been obtained, the plan was declared effective***. On November 29, 1972, the partnership conveyed

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*§55 N.Y.C. Rent Control Regulations. (D22). One petitioner-tenant was subject to the New York City Rent Stabilization Code (D28).

**See first footnote at p. 7, *supra*.

***The partnership undertook to obtain subscriptions from 51% of all of the tenants and claimed to have obtained them.

the building to 34557 Corp. for $1,520,000. The stock was delivered to the purchasing tenants. Unsold shares were sold to one Eileen Dosik, who thereupon became the master tenant of the non-purchasing tenants' apartments.

The Similarity of The Corporation To Conventional Business Corporations

34557 Corp. was formed under the New New York Business Corporation Law and has a charter and by-laws defining its structure and shareholder rights. Its business, including the management and operation of the building, is conducted by corporate officers and a board of directors who can also invest the funds of the corporation in any manner they see fit and declare dividends (D17). Shareholders may participate in the affairs of the corporation through their election of the directors on the basis of one vote for each share held by them and are apprised of its affairs by annual financial reports rendered by the board of directors.

Shareholders have the right at any time to resell their stock at a profit (subject to a restriction on transfer similar to that in conventional corporations) and, in fact, they sought to do so immediately or shortly after making their purchases. Eileen Dosik, who purchased the unsold shares at $100 per share, immediately reoffered them for resale at $270 per share. Within less than a year after purchase, other purchasers reoffered their stock for sale at prices equal to as much as 300% to 600% of what they had paid; and in some instances succeeded in making such sales.

Proceedings Below

Petitioners have challenged the offering in both the State and federal courts. In the New York State Supreme Court, they have instituted a challenge to the offering based upon allegedly arbitrary procedure and lack of jurisdiction of the Attorney General to act within the limits of his authority specified by the provisions of offering literature in accordance with the requirements of State law. (D15). As plaintiffs, they also sued respondents*, as defendants, in the District Court, alleging that they were issuers or underwriters of unregistered securities sold or offered for sale in interstate commerce or by the mails, in violation of §5 of the 1933 Act (D3); that one or more of petitioners were purchasers; that the prospectus or offering statement was materially false and misleading; and that they had relied thereon to their damage. Pendent causes of action, going to the alleged failure of the offering to comply with the substantive requirements of New York State law, accompanied by a claim for declaratory relief, were also asserted. Respondents alleged defenses of lack of subject matter jurisdiction and the intrastate exemption from registration under §3(a)(11) of the 1933 Act. (D3).

On petitioners' motion for summary judgment, the District Court upheld jurisdiction of the subject matter but sustained the intrastate exemption defense. (Bl). On renewal and reargument, wherein petitioners sought

*Apart from the previously described respondents, they include Bernard Cooper et al., who comprise various tenants who supported the plan, purchased thereunder and who are claimed to have actively assisted in its promotion.

further declaratory relief pursuant to Rule 54 of the Federal Rules of Civil Procedure (D32), the District Court adhered to the same position but, prompted by doubts as as to the scope and effect of this Court's decision in *Forman*, granted leave to appeal. (B17).

The Second Circuit reversed the order of the District Court upholding jurisdiction, dismissed the complaint and held that the question as to the availability of the intrastate exemption was moot. (A1, 2). Initially noting that the shares would be deemed "securities" under *Jakobson*, which until then had been the law of the Second Circuit, the Court of Appeals construed that case as being premised solely on the so-called "literal approach" whereby the label "stock" is deemed determinative of whether a "security" is involved. (A8). Then observing that *Forman* had rejected the "literal approach" in favor of a test looking to the "economic reality" of the transaction, the Court of Appeals held that *Jakobson* had been overruled by *Forman* and that the "economic reality" is that the instant stock is not a "security" within the purview of the federal securities laws. (A5, 9-13, D1, 9-10).

The Court of Appeals reached this decision even though *Jakobson* relied upon the "economic reality" test as well as the "literal approach" (365 F. Supp. at 1176; and 503 F.2d at 1378), the scope of *Forman* was expressly limited to stock in publicly sponsored, non-profit, cooperative housing corporations and *not* to stock of the *Jakobson* or instant type involving privately sponsored corporations, where the stock may be resold at a profit (421 U.S. at 840 and 860), and even though saving clauses of the federal securities laws provide:

"If any provision of this act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of the act, and the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby." §26 of the 1933 Act; §33of the 1934 Act. (D9, 14).

According to the Second Circuit, whether the interests involved "be in a publicly or privately financed cooperative residence has no legal significance in [its] view." (A10)

Although this Court in *Forman*, emphasized that the "economic reality" test was primarily concerned with whether the stock could be resold at a profit, the Second Circuit chose to disregard that factor and held that the instant transaction merely involves the acquisition of a residence which might be resold by the purchaser. The Second Circuit concluded: there is nothing to show that the instant investors were motivated by an expectation of profit; dividends on the stock are "impossible to envisage" (A11); the directors' management of the building "is hardly a factor which would result in the appreciation in the value of the shares" (A14-15); and that, as a matter of law, the sole motivation underlying the purchases must have been to enable purchasers to find a place to live, regardless of the fact that they were already tenants of the apartments involved, protectcd in their occupancy by the rent control laws (A10). Since the number of shares is supposedly in proportion to the value of the apartments to which they are allocated, the fact that voting rights depend upon the number of shares held was deemed not to distinguish the

case from *Forman*. The Second Circuit did not mention the admitted fact that immediately or shortly after the purchases, all or most the shares were reoffered for sale and, in various instances, such sales were consummated at substantial profits. No mention was made of other resemblances to conventional business corporations stressed in *Forman* and *Jakobson* as being important.

Reasons for Granting Certiorari

1. The Court of Appeals' unprecedented decision raises issues of urgent national importance. By removing the protection of the federal securities laws against fraud and unfair dealing, the decision will have a direct and substantial effect upon the issuance and sale of stock involving new and converted cooperative apartments which are now occupied by approximately one million people throughout the nation*. It will affect thousands of real estate owners who seek to create cooperatives so as to escape restrictions of rent control laws. It will also affect the regulation and supervision of cooperative housing which has been espoused by many as a major remedy for urban decay.

2. The decision misconceives and misconstrues the scope and effect of this Court's determination in *Forman*,which was explicitly restricted to transactions involving stock in publicly sponsored cooperative housing corporations where the possibility of realizing profits from the ownership or resale of the stock is non-existent. The decision unwarrantably applies

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* See, footnote, at p. 3, *supra*

Forman to exactly those interest which this Court excluded from the scope of *Forman*, viz., stock in privately sponsored cooperative housing corporations where a profit may be realized from the ownership or resale of the stock and where such corporations resemble conventional business corporations in their corporate structure, management by their board of directors and rights accorded to shareholders. By thus removing such stock from the ambit of the securities laws, the decision effectively precludes their operation on stock in *all* types of cooperative housing corporations, whether publicly or privately sponsored, or accompanied by profit incentives, and thereby gives rise to confusion and uncertainty as to the Congressional intent underlying the enactment of the securities laws and the validity, scope and effect of long-standing constructions given them by the SEC, which is charged with their enforcement.

3. The decision undermines well established definitions of "stock" and "investment contract" settled in *Forman* and three other decisions of this Court*, as well as scores of Circuit Court decisions, all of which hold the existence of profit incentives to be of paramount importance in every "stock" or "investment contract" subject to the federal securities laws. The decision ignores or misapplies and, indeed, goes directly against the criteria of a "security" enunciated in *Forman*, whereby profit incentives and similarities to conventional corporations are deemed of the utmost significance.

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*SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344(1943); SEC v. W. J. Howey Co., 328 U.S. 293 (1946); Tcherepnin v. Knight, 389 U.S. 332 (1967).

4. The decision involves important federal jurisdictional issues in areas where Congress, legal scholars* and this Court have previously indicated that jurisdiction ought to be exercised. The 1934 Securities Exchange Act provides for exclusive federal court jurisdiction of violations of its anti-fraud provisions (D12-13); and the 1933 Securities Act provides for concurrent State and federal court jurisdiction of violations of its registration and other provisions. (D7-8). Pressures generated by widespread housing shortages and the inapplicability of rent controls to cooperatives place purchasers in unequal bargaining positions and render them vulnerable to fraud, coercion and other forms of unfair dealing in such transactions, so that they stand in particular need of the disclosure and other protections afforded by the securities laws. This Court has held that the focus of judicial concern in applying these laws should be on persons needing their protection**. The saving clauses of the securities laws preserve their applicability "to persons or circumstances other than those as to which [any of their provisions or the application thereof] is held invalid" (D9, 14). Thus, in the very face of these provisions and without Congressional sanction, the Second Circuit has expansively construed and misapplied this Court's limited holding in *Forman*, thereby harshly depriving such purchasers of the federally pre-empted jurisdiction of securities laws violations and relegating them to ineffective or non-existent remedies under State law.

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*See, footnote at p. 4, *supra*.

**SEC v. Ralston Purina Co., 346 U.S. 119, 127 (1953).

I. The question of whether stock in privately sponsored housing corporations is a "security" under the 1933 Securities Act and the 1934 Securities Exchange Act, where the purchase of such stock is accompanied by profit incentives, is an important question of federal law which should be settled by this Court.

The decision applies to interests in all types of cooperative housing. The case has evoked considerable comment and attention in the legal profession and in lay circles*. Review by this Court is called for because of the striking impact the decision will have on the nation's housing as well as on the federal judiciary and the administration of the federal securities laws.

The Scope of the Decision

This is the only decision, as far as we can discover, containing a restrictive definition of a "security" premised upon a holding that profit incentives are inconceivable in connection with the purchase of stock that can be and is being resold at a profit within a short time after its purchase. It is also the only decision since *Forman* which ignores the limitations placed upon that case by this Court and completely misapplies its explicit tests for a "security" The impact of the decision is immediate and farreaching.

*See, for example, Nov. 4, 1973 N.Y. Times, Sec. 8 (Real Estate), 1, 10, Federal Role on Co-ops Affirmed by U.S. Judge; Oct. 7, 1975 N.Y.L.J. 1, Appeal Certified On Co-Op Stock as Securities; Bloomenthal, The Many Faces of A Security, March 1, 1976 The Practical Lawyer 29, 37; April 29, 1976 N.Y.L.J. 1, 2d Circuit, Citing Supreme Court, Places Private Co-op Shares Outside Stock Laws; May 2, 1976 N.Y. Times 50 L (Main Section) Cooperative Housing Ruling Reversed; August 2, 1976 N.Y.L.J. 1,2, Cooperative Housing And the Securities Laws.

Since *Forman* removes from the federal securities laws transactions in shares of all types of publicly assisted, non-profit cooperatives, and since the only remaining category of cooperatives comprises hundred of thousands of privately sponsored, profit-oriented housing cooperatives throughout the country, the decision effectively completes the removal of the entire cooperative housing industry from regulation under the federal securities laws.

The Impact of the Decision

The impact of this decision promises to be enormous.

1. The most immediate impact will be felt in places where regulation of private cooperatives is ineffective or non-existent and where real estate owners and developers have substantial incentives to offer housing cooperatives without being subject to restrictions against unfair dealing imposed by the federal securities laws. Experience has shown that in such situations, the temptations of "windfall" profits, escape from rent controls, presubscription self-dealing and resort to abuses such as tenant coercion and concealment of material facts bearing upon the desirability of purchasing cooperative apartments become prevalent*. At the same time, purchasers have no alternative protection under State law, especially where interstate offers of stock in such cooperatives are made, State law either being absent or notoriously ineffective in coping with such transactions.

*Cooperative Housing Corporations And The Federal Securities Laws, 71 Col. L. Rev. 118, 119-126 (Jan. 1971); Hearing Told of Need to Guard Rights of Cooperative Buyers, Feb. 7, 1976 N.Y. Times 24, c. 2-3. Cf., June 16, 1974 N.Y. Times 1, Few States Protect Condominium Buyers.

2. Despite provisions of the securities laws conferring upon federal courts exclusive and, under the 1933 Act, concurrent jurisdiction of violations, litigants will be deprived of the benefits of federal jurisdiction and of the rights litigable in the federal courts.

3. The long-standing administrative rules, policies, expertise and guidelines developed by the SEC in regulating and supervising the issuance and sale of stock in privately sponsored cooperative housing corporations have been hopelessly confused and frustrated.

II. The Court of Appeals has misconceived and improperly extended the scope of Forman, and has defied the intent of Congress and the policies of the SEC.

In *Forman*, Mr. Justice Powell, delivering the majority opinion of this Court, explicitly limited the issue involved:

> "The issue in these cases is whether shares of stock entitling a purchaser to lease an apartment in Co-op City, *a state subsidized nonprofit housing cooperative*, are securities within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934." 421 U.S. at 840; *emphasis supplied.*

Again, in resolving this issue in the negative, he emphasized the restricted scope of the *Forman* decision by stating:

> "We decide *only* that the type of transaction before us *in which the purchasers were interested in acquiring housing rather than making an investment for profit,* is not within the scope of the federal securities laws." 421 U.S. at 860; *emphasis supplied.*

It is thus unmistakably clear that the scope of *Forman* does not extend to stock in the only remaining category of cooperatives, such as that with which we are concerned, viz., privately sponsored cooperatives, the stock of which can be purchased for resale at a profit by persons who, at least in part, may be profit-motivated. Such stock falls exactly within the scope of the saving clauses of the securities laws. Since *Forman* invalidates their application to stock of publicly sponsored, non-profit, cooperative housing corporations, §26 of the 1933 Act and §33 of the 1934 Act (D9, 14), by their express terms, require the continued applicability of the Act to stock in the aforementioned remaining category of cooperatives with which we are concerned.

It was manifest error for the Court of Appeals to deem the distinction between the two types of cooperatives of no significance; and it was equally erroneous to hold that *Forman's* rejection of the "literal approach" rendered *Jakobson* "no longer viable" (A5, 10). Examination of that case immediately confirms that it used not only the "literal approach" but also the test of "econo-

mic reality" (503 F.2d at 1378, and 365 F. Supp. at 1176). In applying that test in *Jakobson*, the Court of Appeals examined the structure of the cooperative corporation, the voting rights of its shareholders, their participation in the corporate decision making process and, after concluding "that an even more compelling showing had been made than in *Forman* [which was then at the Circuit Court level] for including the cooperative shares of 1050 Corp. within the ambit of §3(a)(10)" whereby they would be deemed "securities", pointed out that:

> "there is a 'profit' element here that was notably absent in Forman: the shareholder-tenants of 1050 Corp. have the expectation of capital appreciation on a resale of their stock" 503 F.2d at 1377-1378.

The Court added:

> "Finally, the requirement that expectations of profit derive "solely from the efforts of the promoter[s]or a third party", 328 U.S. at 299, ia clearly satisfied here." 503 F.2d at 1378.

Thus, Jakobson remains "viable" because apart from its "literal approach", it was directed to the identical test of "economic reality" imposed in *Forman* and met that test precisely because the character of the *Jakobson* transaction was exactly the opposite to that of *Forman*. The Court of Appeals appears to have overlooked the obvious when it construed *Jakobson* as being based solely on the" literal approach".

By thus denying the application of the securities laws to stock in any type of cooperative housing corporation,

the Second Circuit not only threw into confusion the significance of this Court's holding in *Forman* but also effectively negated and rendered doubtful the effect of the saving clauses in the securities laws and the Rules and policies of the SEC. SEC Rule 235, General Rules and Regulations Under the Securities Act of 1933 (D19), which exempts from the registration requirements of that Act "stock or other securities representing membership in any cooperative housing corporation * * * if the terms and conditions of this rule are met", would, according to the Court of Appeals' decision, have no subject matter upon which to operate - regardless of whether "the terms and conditions of this rule are met." The same is true respecting SEC Rule 15a-2, General Rules and Regulations Under the Securities Exchange Act of 1934 (D21), which expressly exempts from the broker-dealer requirements of that Act stock in cooperative housing corporations unless it falls within a specified exception. The decision also throws into confusion the policies of the SEC whereby it has been applying the requirements of the securities laws to privately sponsored cooperatives for many years. *

Significantly, the Court of Appeals did not refer to the Rules or policies of the SEC in reaching its decision, which now casts doubt on their viability and, in large part, defeats their very purpose which is to afford protection under the securities laws to purchasers of stock in cooperatives and other corporations who need such protection.

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*In or about 1954, for example, a privately sponsored cooperative housing corporation, known as the Carnegie Hill Apartments in New York City, was required to file with the SEC its offering of stock under so-called Regulation A of the federal securities laws. Thereafter, the SEC continued to apply such policies.

III. The decision undermines established definitions of a "security".

The Court of Appeals' unprecedented decision seriously undermines *Forman* and three other decisions of this Court, as well as scores of Circuit Court decisions, which have firmly established the paramount importance of profit incentives in determining the presence of a "stock" or "investment contract", and hence of a "security", under the federal securities laws.

Thirty years ago, this Court enunciated the controlling definition of an investment contract in *SEC* v. *W. J. Howey Co.*, 328 U.S. 283, 298-299:

> "* * * [A]n investment contract is * * * a contract, transaction or scheme whereby a person invests his money in a common enterprise and is *led to expect profits* solely from the efforts* of a promoter or a third party * * *." *Emphasis supplied.*

The possibility of profit is thus a critical element in an investment contract (and indeed, in every security.) 328 U.S. at 296. Three years earlier, this Court, in *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, at 352-353, pointed to the same element as being critical - "the economic inducements held out to the prospect", i.e., to the purchaser.**

*SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482, elaborates upon the nature of the required "common enterprise" and indicates that the "efforts"requirement is satisfied where there are "essential managerial efforts [by other than the investor] affecting the success or failure of the enterprise."

**The Court again adhered to the rule of *Joiner* and *Howey* in *Tcherepnin* v. *Knight*, 389 U.S. at 336-338.

The potentiality of substantial monetary profit on one's investment is thus a central and highly significant element of every investment contract, stock and security. Numerous decisions in various Circuits have articulated that principle*.

Its vitality was also reaffirmed by this Court in *Forman*. The main "economic reality" of the *Forman* situation, which this Court stressed as being determinative of its decision, was that *Forman* involved no possibility of profit and was *solely* directed to securing apartments for purchasers of the securities in equestion. As Mr. Justice Powell pointed out in holding that the shares in *Forman* were not "stock" governed by the securities laws although denominated as such:

> "Despite their name, they lack what the Court in Tcherepnin v. Knight, 389 U.S. 332 (1967) deemed the most common feature of stock: the

*See, e.g., *SEC* v. *Haqenden-Rimar International, Inc.*,496 F.2d 1192 (4 Cir. 1974), aff'g 362 F. Supp. 323 (E.D. Va. 1973) (sales of interests in scotch whiskey held to be investment contracts, where there were possible returns of 20 to 25% annually, doubling investment in four years. The District Court noted that even if defendants were merely selling an interest in whiskey, when that interest becomes the subject of speculation, it becomes a security); *Nor-Tex Agencies, Inc.* v. *Jones*, 482 F.2d 1093 (5 Cir. 1973), cert. den. 415 U.S. 977 (1974) (interest in real estate and mineral rights held to be an investment contract; Court held that there was possibility of profits in a fractional oil and gas interest); *SEC* v. *Koscot Interplanetary, Inc.*, 497 F.2d 473 (5 Cir. 1974), involving the possibility and expectation of "galactic profits" from a pyramid scheme; *Glen-Arden Commodities Inc.* v. *Costantino*, 493 F.2d 1027 (2 Cir. 1974), involving the possibility of doubling one's money from purchases of warehouse receipts and evidences of ownership of Scotch whiskey; *Continental Marketing Corp.* v. *SEC*, 387 F.2d 468 (10 Cir. 1967), cert. den. 391 U.S. 905 (1968) (sale of beavers is investment contract where there was a possibility of "geometric profits").

right to receive 'dividends contingent upon an apportionment of profits.' 389 U.S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting right in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was *solely* to acquire subsidized low-cost space; *it was not to invest for profit.*" 421 U.S. at 851; *emphasis supplied.*

Again, in pointing out that the *Forman* shares did not meet the test of an investment contract, contemplated by the securities laws, Mr. Justice Powell reiterated that profit from the transaction was unavailable or unanticipated.

> "In the present case there can be no doubt that investors were attracted *solely* by the prospect of acquiring a place to live and *not* by financial returns on their investments." 421 U.S. at 853; *emphasis supplied.*

Significantly, also,*Forman* does not require that the expectation or inducement of profit, as such, be expressly held out by the offeror or be set forth explicitly in the offering literature. It is enough if the stock is negotiable and may appreciate in value, or may be the subject of dividend declarations, or that the corporate structure and management are such as to permit or facilitate the realization of profits from the ownership or sale of the stock. It is sufficient if the circumstances surrounding a purchase reflect the possi-

bility or expectation of profit; and it is only by virtue of a consideration of all such circumstances that the "economic reality" test acquires any significance. Otherwise there would be no point in *Forman* or *Jakobson* or Rule 235 of the General Rules and Regulations Under the Securities Act of 1933 distinguishing between the kinds of cooperative securities which are subject to the securities laws and those which are not. The wording of any offering literature relating to any cooperative plan (or indeed, to any security) could readily be phrased to circumvent application of the securities laws simply by avoiding any discussion of prospective profits, and this even though such prospects might be evident from the surrounding circumstances.*

It was thus clearly erroneous for the Second Circuit to fail to apply the criteria expressly announced in *Forman* to the instant case where profit incentives and the various factors facilitating the realization of profit were clearly present and resulted in substantial profits to purchasers. Here, the shares were transferable and negotiable, could appreciate in value so as to yield a profit, *did yield substantial profits upon resale shortly after their purchase,* and shareholders could receive dividends when declared. The Second Circuit could not properly hold, as a matter of law, that the purchasers' sole motivation was to find a place to live, especially where rent control laws furnished them significant pro-

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*Indeed, the SEC restricts or prohibits projections of profit in registration statements (which include offering statements) and it is well known that such projections are usually extrinsic thereto (Brodsky. Corporate and Securities Litigation, The Securities Laws: Claims Involving Economic Forecasts, at p. 1, New York Law Journals of Nov. 19, Dec. 3 and 17, 1975.

tection against eviction if they refrained from purchasing*. Additionally, it will be seen that the corporate structure, the management of the corporation by corporate officers and a board of directors, the right of shareholders to participate in the corporate decision making process by electing directors on the basis of one vote for each share held, and the directors' obligation to render annual reports to the shareholders are all factors stressed by this Court in *Forman* as being indicative of the presence of a "stock" or "investment contract" under the securities laws - as was also emphasized by the Second Circuit in *Jakobson*.

It is simply and transparently incorrect for the Second Circuit, under the mantle of *Forman*, to hold that such factors, though present, do not indicate the existence of a "security" or, as a matter of law, that they are inapplicable to the case at bar. Such a holding renders the law of the Second Circuit completely uncertain and irreconcilably opposed to the firmly established principles enunciated by this Court and by the other indicated Circuit Courts of Appeals, as well as the panel of the Second Circuit in *Jakobson*. Purchasers and offerees of stock in a privately sponsored cooperative housing corporation can no longer rely with confidence upon the criteria announced by this Court in *Forman* as indicative of the kind of security they hold or may acquire and are precluded from any significant knowledge of their rights in respect thereto.

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*See, p. 8, *supra*.

IV. The decision of the Second Circuit involves important statutory issues and calls for an exercise of this Court's power of supervision.

By its obvious failure to adhere to the principles laid down so recently in *Forman*, the Court of Appeals has effectively nullified the statutory saving clauses in the securities laws, the rules and policies of the SEC relating to its enforcement of those laws, and has conflicted with the recent previous holding of another panel of the same Circuit in *Jakobson*. Moreover, the decision has effectively nullified the intent of Congress to provide an exclusive federal forum for remedying violations of the 1934 Act (D12-13); and has relegated litigants, who need protection against such violations, to non-existent or doubtful substitutes for such remedies in the State Courts. Under these circumstances, the only way that the situation may be redressed is through review by this Court or perhaps, through a remand of the case for an en banc hearing by the Second Circuit.

CONCLUSION

For the foregoing reasons, this petition should be granted and a writ of certiorari should be issued to review the decision below; or if such relief be not afforded so as to result in review by this Court, the case should be remanded for a hearing before all of the Judges of the Second Circuit sitting en banc.

Respectfully submitted,

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Attorney for Petitioners

WILLIAM LYON EVERS
Of Counsel

Appendix A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 601, 661—September Term, 1975.

(Argued March 15, 1976 Decided April 28, 1976.)

Docket Nos. 75-7592, 75-7601

MAX GRENADER, ROGER W. ACH, II, ANN FIELDER, JOHN GERSTAD, LEE GERSTAD, CELIA GORDON, P. BENJAMIN KAUFMAN, DOROTHY KIMBALL, GERTRUDE LANDAU, HORACE MILLS, ADRIENNE MINASSIAN, SYLVIA JANE MORRISON, CORA MULLER-THYM, H. VICTOR SCHWIMMER, FRANCES STEIN, MARION TERRES, JOHN TERRES, MASIE G. WILKINSON, OLGA RUDNYANSKY, MADELINE SCHAINUCK,

Plaintiffs-Appellants-Appellees,

—against—

MILTON SPITZ, HENRY SPITZ and JEROME SPITZ, d/b/a THREE FORTY FIVE MANAGEMENT CO., 34557 TENANTS CORP.,

Defendants-Appellees-Appellants,

BERNARD COOPER, ROBERT JULIUS, JERRY V. SHIELDS, JR., WILLIAM L. LIVINGSTONE, JOEL KEY RICE, FRANK MOORMAN, JUDITH ANN TAFT, GLORIA LISTER a/k/a GLORIA HAHN, SYLVIA SPITZ, ERNEST BORKLAND, JAMES DANIEL COTTON, BOBBY MITCHEL and S. MERCER MOORMAN,

Defendants.

Before:

MULLIGAN, GURFEIN, *Circuit Judges* and
NEAHER,* *District Judge.*

Appeals by permission from an order of the United States District Court for the Southern District of New York, Hon. Charles E. Stewart, Jr., *Judge,* which held that 1) the intrastate exemption was available for the shares of stock issued by the defendant corporation, and 2) that the shares were securities within the federal securities laws, and certified both issues for immediate review pursuant to 28 U.S.C. § 1292(b).

Reversed on the second issue certified, with directions to dismiss the complaint. The first issue is rendered moot.

CHARLES MARKS, New York, New York, *for Plaintiffs-Appellants-Appellees.*

DENNIS J. BLOCK, KEVIN P. HUGHES, New York, New York (Weil, Gotshal & Manges, New York, New York), *for Defendants-Appellees-Appellants.*

MULLIGAN, *Circuit Judge:*

We are presented here with the question whether the sale of the stock in a privately owned and operated New York City apartment house cooperative constitutes the sale of a "security" within the Securities Act of 1933 (15 U.S.C. § 77a et seq.) and the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.). We answer the question in the negative primarily on the authority of

* Edward R. Neaher, United States District Judge for the Eastern District of New York, sitting by designation.

United Housing Foundation, Inc. v. *Forman,* 421 U.S. 837 (1975).

This action was commenced in the United States District Court for the Southern District of New York by the tenants of seventeen apartments in an apartment building located at 345 East 57th Street in the City of New York (the Building) which has been converted into a cooperative housing corporation according to the General Business Law of the State of New York (§ 352-e et seq.). The defendants Milton Spitz, Henry Spitz and Jerome Spitz, former owners of the Building, are sued individually and as a partnership doing business as Three Forty Five Management Co., the sponsor of the cooperative conversion plan and managers of the Building. The defendant 34557 Tenants Corporation (the Corporation) is a New York corporation organized by the sponsor to consummate the conversion by issuing its stock to tenants in return for money to be used to purchase the Building. The other named defendants are tenants who supported the conversion plan and purchased stock pursuant to it.

The complaint which was filed on September 6, 1972, contained four causes of action. The first alleged violations of sections 5 and 17 of the Securities Act of 1933 (15 U.S.C. §§ 77e and q), section 10(b) of the Securities and Exchange Act of 1934 (15 U.S.C. § 78j(b)) and rule 10b-5 on the ground that the shares sold were never registered with the Securities and Exchange Commission and that the prospectus through which they were offered contained misleading statements or omissions of material facts. The second cause of action claimed the commission of a prima facie tort by the defendants in seeking acceptance of the conversion plan. The third cause of action alleged that there was a failure to comply with the filing requirements of sections 352-e(1)(a) and (b) of the New York General Business Law. The fourth cause of action

pleaded that the defendants had failed to obtain the subscription by 51% of the tenants before the May 16, 1972 deadline provided in the prospectus. Plaintiffs sought damages of $14,600 on the first cause of action and $500,000 on the second, as well as declaratory relief on the third and fourth causes. The defendants alleged affirmative defenses to the first cause of action, claiming that there was no subject matter jurisdiction, that the cooperative plan was exempt from registration under section 3(a)(11) of the 1933 Act (15 U.S.C. § 77 c (11)) (the intrastate exemption), and that therefore the court also had no jurisdiction of the pendent state claims. The defendants further claimed that the actions were barred by a prior pending action in the New York State Supreme Court based on the same facts.

By notice of motion dated November 17, 1972, plaintiffs moved for summary judgment on the first, third and fourth causes of action and to strike the affirmative defenses. In a memorandum decision and order of March 3, 1975 (reported at 390 F. Supp. 1112), District Court Judge Charles E. Stewart, Jr., in reliance upon this court's decision in *1050 Tenants Corp.* v. *Jakobson,* 503 F.2d 1375 (2d Cir. 1974), found that subject matter jurisdiction was properly predicated upon the federal securities laws. He further held that the issue was exempt from registration under the intrastate exemption of the 1933 Act. He denied the motion for summary judgment, finding genuine issues of material fact in both the federal and state causes of action. The Supreme Court decided *United Housing Foundation, Inc.* v. *Forman, supra,* on June 16, 1975 and the defendants, on June 25, 1975, moved orally for dismissal of the complaint for lack of subject matter jurisdiction in light of the *Forman* holding.

In a memorandum decision and order of September 26, 1975, Judge Stewart reaffirmed his prior holding that no

registration was necessary by reason of the intrastate exemption. He further held that the shares of stock of the defendant Corporation were distinguishable from those considered by the Court in *Forman* and were securities and investment contracts within the federal securities laws. The court then certified two questions for appellate review in accordance with 28 U.S.C. § 1292(b):

> "(1) Whether the intrastate exemption under § 3(a)(11) of the Securities Act of 1933 is available in the case at bar, and (2) whether the securities here come within the purview of the federal securities laws . . ."

On October 25, 1975, this court granted leave to appeal on these two questions. Concluding that our decision in *1050 Tenants Corporation* v. *Jakobson* is no longer viable by reason of the holding in *Forman*, we hold that the shares here involved are neither securities nor investment contracts within the federal securities laws. The question of exemption is therefore rendered moot. We reverse the order below on the second question certified and direct the dismissal of the complaint, including the pendent claims in the second, third and fourth causes of action.

Facts

The focal point of this controversy is a residential apartment house constructed in 1929 and containing sixty dwelling units. Forty-two apartments were rent-controlled and eighteen apartments were rent-stabilized. There are no commercial units on the premises.

In December 1942, the Building was acquired by Milton Spitz, Edward Spitz, Henry Spitz and Jerome Spitz, as trustees for their mother, Minnie Spitz, and by Jerome Spitz individually. At or about the time of this acquisition, the family formed a partnership which did business under

the firm name Three Forty Five Management Company. Thereafter, the Building was managed and operated by the partnership.

An unsuccessful attempt at converting the Building to a cooperative was made in 1969. In view of the magnitude of tenant opposition at that time, the plan was withdrawn and abandoned. Two years later, on June 3, 1971, the Spitz brothers entered into an agreement among themselves to sponsor and promote the instant plan of conversion. They proposed to form a corporation which would issue its shares to the tenants, and use the proceeds to purchase the Building from the sponsoring partnership. In accordance with this agreement, the Spitz brothers caused the 34557 Corporation (sued herein as "34557 Tenants Corp.") to be formed under the New York Business Corporation Law. This corporation has an authorized capital of 7,000 shares of stock with a par value of $1.00 per share. The trust which had been administered by the partnership terminated with the death of Minnie Spitz on August 18, 1971. On September 17, 1971, the offering plan was filed by the sponsor with the Attorney General of the State of New York as required by section 352-e of the General Business Law. It was submitted to the tenants of the Building on the same date.

The content of the plan was principally devoted to the real estate interests being conveyed. The purchaser had to enter into a subscription agreement for the number of shares allocated to the unit in which he was interested, and was thereby entitled to a proprietary lease for his apartment. The apartments would be sold for residential use and the maintenance fees received from the respective owners would constitute the cooperative's income. These receipts would be slightly augmented by rental income of $180 per month from a laundry concession maintained in the basement for the tenants' convenience, and by a 5% commission

on gross receipts from tenants who subscribed to Manhattan Cable Television. The prospectus set forth the tenants' respective statutory rights, and included a copy of the subscription agreement, proposed proprietary lease and by-laws of the Corporation.

The shares of stock received by tenants are not freely transferable. The stock cannot be transferred except in connection with the purchase and delivery by the cooperative of a proprietary lease for the apartment to which the shares were allocated. Prior approval of such a transfer was required by either a resolution of the directors of the Corporation, by written authorization of a majority of the directors, or by written consent or affirmative vote of lessees owning 65% of the then-issued shares. A restrictive legend to this effect was printed on the share certificates.

The actual ownership of the individual apartments was governed by the proprietary lease, the execution of which was a condition precedent to tenancy. This document fixed the arrangement for contributions by apartment owners to the cash needs of the Building for its common expenses, and set forth restrictions and requirements for the subletting or transferring of ownership rights. Upon failure to contribute to common expenses, bankruptcy, improper transfer of the shares, improper assignment or subletting, or breach of any other provision of the lease, the Corporation can give notice of expiration of the tenancy and the owner was required to surrender his apartment.

Under the offering plan in its original form, the cooperative was to acquire the Building from the sponsor for $2,140,000; $840,000 was to be realized from the sale of stock, and the balance of $1,300,000 was in the form of mortgage indebtedness. A reserve fund for repairs of $97,500 was to be retained by the cooperative from the purchase price, reducing the sponsor's net proceeds to $2,042,500. As a result of negotiations among the sponsor,

the tenants, and the Attorney General, a series of amendments was proposed which reduced the purchase price, increased the cooperative's reserve fund, increased the required percentage of subscribing tenants and extended the plan's expiration date. The conversion was declared effective by an amendment dated June 6, 1972, and the sponsor delivered the deed to the cooperative on November 29, 1972. On December 11, 1972, the shareholders elected directors and officers to serve until the next annual meeting.

THE LAW

There is no doubt that the shares of stock involved here would be deemed securities within the federal securities acts[1] under the holding of this court in *1050 Tenants Corp.* v. *Jakobson,* 503 F.2d 1375 (2d Cir. 1974). However, Judge Timbers' opinion there was premised upon the so-called "literal" approach adopted by Judge Oakes in his opinion in *Forman* v. *Community Services, Inc.,* 500 F.2d 1246 (2d Cir. 1974) which was reversed by the Supreme Court in *United Housing Foundation, Inc.* v. *Forman, supra.* The "literal" approach as defined by Judge

1 Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1), provides:

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

This definition is virtually identical to that contained in section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c (a)(10), and the two will be considered together for purposes of this discussion. *Tcherepnin* v. *Knight,* 389 U.S. 332, 342 (1967).

Oakes was simply "the fact that 'stock' certificates are used in a 'stock' corporation is sufficient in itself to bring transactions in the 'stock' within the literal definition of the Acts." 500 F.2d at 1252.

This "literal" approach was explicitly rejected, however, by the Supreme Court in its reversal of the holding in *Forman.* Mr. Justice Powell in his opinion for the Court stated:

> We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:
>
> "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight,* 389 U.S. 332, 336 (1967).

421 U.S. at 848.

Looking at the realities, the Court noted that "[c]ommon sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock." Id. at 851.

The Court in *Forman* was considering shares of stock in "Co-op City," a New York City public housing cooperative which was publicly subsidized under the Mitchell-Lama Act, New York Private Housing Finance Law §§ 10-37. The housing here was privately sponsored and owned

and the question at issue is whether this fact sufficiently distinguishes the case from *Forman* so that *Jakobson,* which also involved a private cooperative, remains viable. We hold that the shares here are not securities under the federal acts and that *Forman* effectively overruled *Jakobson.*

Jakobson was, as we have pointed out, explicitly bottomed on the literal approach of our holding in *Forman* which is now discredited. See *1050 Tenants Corp.* v. *Jakobson, supra,* 503 F.2d at 1378. The Supreme Court's opinion in *Forman* stressed "economic reality" and emphasized that the tenants there were seeking residential housing for their personal use and were not purchasing investment securities simply because the transaction was evidenced by shares of stock. We think the same reality exists here. The tenants were seeking a place to live and whether their residence be in a publicly or privately financed cooperative residence has no legal significance in our view. While the initial offering was made to those who already occupied apartments in the Building and who were rent-controlled or rent-stabilized, this is a requirement of New York law. (Rent and Eviction Regulations of the Housing and Development Administration § 55, and Code of the Real Estate Industry Stabilization Association of New York City, Inc. § 61, both following N.Y. Unconsol. Laws § 8617). Once the Building became a cooperative they were no longer protected by these provisions and could be evicted, so that their obvious motive in purchasing shares was to retain their residence. A reading of the offering plan, the proprietary lease and subscription agreement make it crystal clear that the purchase of stock was completely tied to the lease of the apartment. The shares cannot be transferred to a non-tenant; a terminating tenant is required to relinquish his stock and the purchaser must execute a proprietary lease

and be acceptable as a tenant to the board of directors of the cooperative.

The Court in *Forman* also pointed out that the most common feature of stock is "the right to receive 'dividends contingent upon an apportionment of profits'." 421 U.S. at 851, quoting *Tcherepnin* v. *Knight, supra,* 389 U.S. at 331. There is no affirmative provision for the payment of dividends in the transaction before us. Article III, § 10 of the by-laws provides:

> Distributions: The shareholders-tenants shall not be entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the Corporation, to receive any distribution not out of earnings and profits of the Corporation.

The appellees argue that this clause implies that distribution *may* be made out of earnings and profits. Under the economic reality test of *Forman,* it is indeed impossible to envisage what cash dividends would be reasonably anticipated from the operation of a cooperative residential housing venture. The only substantial income of the Corporation arises from the payment of rent or maintenance charges by the tenants, estimated on the basis of the cash requirements needed to operate the Building on an annual basis plus the creation of reserves for contingencies. Unlike *Forman,* there are no commercial tenants in the Building. Aside from rental income are the fees realized from the coin-operated laundry and cable television which, of course, are tenant-financed and not significant. There is not a scintilla of evidence that any tenant was induced to become a purchaser of shares because he might expect to realize dividends. Whatever profit might be realized could only result in a reduction of the maintenance charged. Realistically, in view of continuously escalating labor, fuel and maintenance costs, all that a ten-

ant could reasonably expect would be escalating monthly charges. The argument that a share purchaser was induced to acquire his apartment because of an opportunity to realize cash dividends is altogether frivolous.

As we have already indicated, the shares here were not negotiable absent a sale of the apartment; they could not be pledged or hypothecated unless as security for a loan to purchase the tenancy. In sum, none of the characteristics of ordinary shares of stock are present here. In fact, the continuing obligation to pay a monthly rental fee to maintain the tenancy of the lessee strongly supports the conclusion that this was basically a real estate transaction and not an investment in a security.

In *Forman,* the voting rights of the shareholder were on the basis of one vote for each apartment irrespective of the number of shares owned. The Court in *Forman* pointed out that in contrast, in the usual corporate venture the shareholder's vote does depend upon the number of shares held, 421 U.S. at 851. Appellees urged that here the shareholder's voting power depends upon the number of shares owned and that *Forman* is thus distinguished. The argument is without merit. The number of shares that a tenant can purchase is fixed by the offering plan and is clearly in proportion to the size and location of the apartment leased. Thus the lessee of a first floor, five room apartment is obligated to purchase 100 shares while the lessee of a sixteenth floor, six room apartment is required to purchase 159 shares. Thus if anything, the relationship of share purchase here to actual apartment residency is even more direct than in Co-op City, where the apartments were fungible as far as voting rights were concerned.

Appellees' major argument in distinguishing *Forman* is that the lessee in Co-op City whose tenancy is terminated, voluntarily or otherwise, is required to offer his stock to the housing corporation at its initial selling price.

Since he is the beneficiary of a public subsidy, the requirement that he make no profit is understandable. In contrast, the tenant of the private cooperative Building here admittedly has the right to dispose of his apartment and his shares to a new and approved lessee-purchaser at whatever price the real estate market then permits. Hence, there is an opportunity to make a profit and it is urged that this is a normal characteristic of a security or, more accurately, an investment contract within the securities acts. Moreover, the court in *Jakobson, supra,* 503 F.2d at 1378, so held. Again, we hold that the opinion of Mr. Justice Powell in *Forman* is definitive.

As we have already indicated, the transaction here essentially involves the acquisition of a residence. Just as the purchaser of a private one family residence is not unaware that he may eventually sell his property at a profit or loss depending upon the vagaries of the real estate market, so the proprietary lessee of a privately owned cooperative cannot be unconscious of the fact that upon its disposal he will gain or lose depending upon the same market factors.

More pointedly, the *Forman* Court (421 U.S. at 852-53) adopted the definition of an investment contract set forth in *SEC* v. *W. J. Howey Co.,* 328 U.S. 293 (1946). That opinion defines the term as follows:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . .

Id. at 298-99.

We note initially that the *Howey* test first requires that the investor be "led to expect profits." There is nothing in the record before us to support the conten-

tion that the investor here was attracted by the prospect of realizing a profit on his investment. While the court below found that the tenants were attracted by the dual motives of obtaining housing and realizing a profit on their investments, the documentary evidence, which is all that was before the court, would indicate that the profit motive, if any, was purely incidental. The offering plan, which includes the subscription agreement, the proprietary lease and the by-laws is barren of any representation or intimation of anticipated profits. Unlike the hawking siren song of the promoter, the plan here is a prosaic recitation of the financial facts underlying the transaction with an exhaustive recitation of the physical properties and condition of the Building and the apartments offered as well as the terms of the tenancy and the obligations of the lessee. There is no reference to the possibility or probability of profits. In fact, there is ample warning that the annual maintenance charges set forth for each apartment (together with the purchase price of the shares fixed for each unit) are only estimates. An enclosed letter provides: "It may be expected, based on current trends, that such items as real estate taxes, fuel costs, maintenance, repairs, labor and other related expenses will change in the future." Appellees, apparently aware of the failure of proof of inducement, include in an addendum to their brief exhibits outside the record indicating that tenant meetings were held to discuss the offering plan. What inducements, if any, were there made are consequently not before us.

There is a further flaw in appellees' argument. *Howey* requires that the profits arise "solely from the efforts of the promoter or a third party." 328 U.S. at 299. While efficient management of the cooperative will enhance its desirability as a place of residence, it is hardly a factor which would result in the appreciation in value of the

shares of a Corporation operating a Building nearly fifty years old. Realistically, that will depend upon the general housing market, the status of the neighborhood and the availability of credit. See Berman and Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesites, 30 Bus. Law. 411, 422-24 (1975).

The distinction between the investment contract and the transaction under scrutiny here becomes apparent when we examine the cases relied upon in *Forman.* Thus in *Howey,* a Florida corporation owning large citrus acreage offered small parcels of orchard land to investors along with a service contract. The purchasers' tracts were then jointly cultivated, the company sold the produce and investors received a portion of the profits based on the acreage they owned. This was held not to be a purchase of real estate but rather an investment for profit. "The resulting transfer of rights in land is purely incidental." Id. at 300.

Similarly, in *SEC* v. *C.M. Joiner Leasing Corp.,* 320 U.S. 344 (1943), lessees of large tracts sold leases of the property representing that test oil wells would be drilled. The promotional literature touted the well and the potential return to the investor. The Court found the transactions were investment contracts and securities within the 1933 Act.

As the Court in *Forman* noted, "when a purchaser is motivated by a desire to use or consume the item purchased—'to occupy the land or to develop it themselves,' as the *Howey* Court put it, [328 U.S. at 300]—the securities laws do not apply." 421 U.S. 852-53.

We reiterate that viewing the economic realities, the purchasers here desired to personally occupy the apartments and were not led to expect bonanza profits analogous to the oil wells or citrus orchards discussed above. We therefore conclude that *Jakobson's* holding that the

private cooperative shareholder tenancy is an investment contract under the federal securities acts cannot survive the *Forman* analysis.

While profits may also result from a participation in earnings resulting from the use of investors' funds, *Tcherepnin* v. *Knight, supra,* 389 U.S. 332, no serious argument can be made that funds invested here were ever intended to be devoted to anything but the purchase of the Building and its maintenance. Whatever excess might exist would normally be expected to be placed in interest bearing accounts or secure investments but this is hardly within the statutes.[2]

While the holding here deprives the investors of whatever protection the federal securities laws provide, this is, as we have discussed, by virtue of authoritative and persuasive construction of those acts by the Supreme Court. Moreover, real estate transactions are traditionally left to state supervision. The transaction here involved is regulated by the Martin Act in New York and litigation is now pending in the courts of that state involving the very issues raised here.[3]

The order appealed from is reversed and the complaint dismissed.

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2 In *Tcherepnin*, an Illinois Savings and Loan Association sold withdrawable capital shares, the holder becoming a member of the Association. The shares had no fixed rate of return, and dividends were based on the profits of the Association. In finding this arrangement to be an investment contract, the Court held: "Petitioners are participants in a common enterprise—a money-lending operation dependent for its success upon the skill and efforts of the management of City Savings in making sound loans." Id. at 338. The case is therefore distinguishable.

3 The Martin Act in New York State (N.Y. General Business Law § 352-e) requires the filing of the offering plan. Appellees commenced an action in the state court, charging omissions and deficiencies in the plan and naming the Attorney General as a defendant. That litigation, commenced in 1972, is still on appeal to the New York Court of Appeals. In July 1975, the appellees commenced another action in the state courts alleging common law fraud.

Order of Kaufman, J., Denying Petition For Rehearing

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 20th day of July, one thousand nine hundred and seventy-six

75-7592

Max Grenader, Roger W. Ach II, Ann Fielder, John Gerstad, Lee Gerstad, Celia Gordon, etc.
Plaintiffs-Appellees-Appellants,

v.

Milton Spitz, Henry Spitz and Jerome Spitz, d/b/a Three Forty Five Management Co., etc.,
Defendants-Appellants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the Plaintiffs-Appellees-Appelants, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

/s/ IRVING R. KAUFMAN,

IRVING R. KAUFMAN, Chief Judge

Appendix A

Order Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 20th day of July, one thousand nine hundred and seventy-six.

Present:

Hon. WILLIAM H. MULLIGAN,
Hon. MURRAY I. GURFEIN, Circuit Judges.
Hon. EDWARD R. NEAHER, District Judge.

75-7592

Max Grenader, Roger W. Ach II, Ann Fielder, John Gerstad, Celia Gordon, etc.,

Plaintiffs-Appellees-Appellants,

v.

Milton Spitz, Henry Spitz and Jerome Spitz, d/b/a Three Forty Five Management Co., etc.

Defendants-Appellants-Appellees.

A petition for a rehearing having been filed herein by counsel for the plaintiffs-appellees-appellants

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/A. DANIEL FUSARO
A. DANIEL FUSARO
CLERK

Appendix B

Opinion of the District Court On Plaintiffs' Original Motion

MAX GRENADER et. al.,

Plaintiffs,

v.

MILTON SPITZ et al.,

Defendants.

No. 72 Civ. 3784
United States District Court
S. D. New York
March 6, 1975

Charles Marks, New York City, for plaintiffs, Max Grenader, Roger W. Ach II, Susanne Buchner, Ann Fielder, John Gerstad, Lee Gerstad, Celia Gordon, P. Benjamin Kaufman, Dorothy Kimball, Gertrude Landau, Horace Mills, Adrienne Minassian, Sylvia Jane Morrison, Cora Muller-Thym, H. Victor Schwimmer, Frances Stein, Davidson Taylor, Marion Terres, John Terres, Masie G. Wilkinson, Olga Rudnyansky and Madeline Schainuck.

Kevin P. Hughes, Weil, Gotshal & Manges, New York City, for defendants, Milton Spitz, Henry Spitz and Jerome Spitz, d/b/a Three Forty Five Management Co., and 34557 Tenants Corp.

Joel Arnold, Blumenthal, Barandes, Bass, Matson & Arnold, New York City, for defendants, Bernard Cooper, Robert Julius, Jerry V. Shields, Jr., William L. Livingstone, Joel Key Rice, Frank Moorman, Judith Ann Taft, Gloria Lister a/k/a Gloria Hahn, Sylvia Sylvia Spitz, Ernest Borkland, James Daniel Cotton, Bobby Mitchel and S. Mercer Moorman.

STEWART, DISTRICT JUDGE:

This action was brought by various tenants in an apartment building located at 345 East 57th Street, New York, New York, which has been converted to a cooperative housing corporation. Plaintiffs challenge the offering statement and plan pursuant to which shares in the apartment were sold. They allege that the defendant partnership, sponsor and promoter of the cooperative plan pursuant to which the corporation was organized and shares offered and sold, violated provisions of federal[1] and state[2] securities laws and regulations by failing to register the shares sold with the Securities and Exchange Commission, by making false and misleading statements and material omissions in connection with and in the course of issuance of the shares, and by failing to obtain subscriptions by the necessary number of

1. The first cause of action alleges violations of Sections 5 and 17 of the Securities Exchange Act of 1933. 15 U.S.C. §77e and q; Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) and Rule 10b-5 (17 C.R.F. §240.10b-5) ("the federal causes of action")

2. The third cause of action ("the pendent state claims") alleges violation of §352-e(1)(a) and (b) of the New York General Business Law.

tenant participants by the offering's deadline.[3]

Defendants Milton Spitz, Henry Spitz, and Jerome Spitz sued individually and as a partnership doing business as Three Forty Five Management Co., and defendant 34557 Corporation, the tenant corporation formed when the plan became effective, allege as affirmative defenses that the cooperative plan was exempt from the registration requirements of the Securities Act of 1933, and that therefore this court is without subject matter jurisdiction over the pendent state claims. Various tenants of the apartment building, who are also defendants, allege as affirmative defenses that this court is without subject matter jurisdiction over the entire action and that this action is further barred by the pendency of a prior action in the New York State Supreme Court based on the same set of facts.[4]

Plaintiffs now move for partial summary judgment contending there are no genuine issues of fact to be decided as to the first, third and fourth causes of action. Essentially, plaintiffs argue that as a matter of law the shares offered by the sponsor constituted securities required to be registered under §5 of the Securities Act of 1933 and did not constitute an exempt intrastate offering under §3(a)(11) of the 1933 Act. With respect to the first and third causes of action, plaintiffs also argue that the

3. The second cause of action, alleging the commission of a common law tort, is not part of this motion.

4. We dismiss the affirmative defense of the individual defendants that this action is barred by the pendency of a similar action in the New York state courts. *Atlantic Coast Line R.R.* v. *Brotherhood of Locomotive Engineers*, 398 U.S. 281, 295-96 (1970); *Kline* v. *Burke Construction Co.*, 260 U.S. 226 (1922); *Friedman* v. *N.B.C. Motorcycle Imports Inc.*, 452 F2d 1215, 1217 (2d Cir. 1971).

purportedly misleading statements and omissions in the defendant sponsor's offering statement and amendments are so clearly material that summary judgment is warranted as a matter of federal and state securities law. The final contention, plaintiffs' fourth cause of action, is that the requisite level of tenant participation in the cooperative plan was not timely obtained, and hence the whole plan must fail.

This court finds that subject matter jurisdiction over this controversy is properly predicated upon §22 of the Securities Act of 1933[4a] and upon §27 of the Securities Exchange Act of 1934[5] as construed by the recent Second Circuit decision in *1050 Tenants Corp.* v. *Jakobson*, 503 F.2d 1375 (2d Cir. 1974). Since there is subject matter jurisdiction with regard to the federal cause of action, we may, in our discretion, retain jurisdiction over pendent state causes of action derived from "a common nucleus of operative fact." *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 725 (1966). See also *Almenares* v. *Wyman*, 453 F.2d 1075, 1083-86 (2d Cir. 1971), *cert. denied*, 405 U.S. 944 (1972); *Drachman* v. *Harvey*, 453 F.2d 722, 737-38 (2d Cir. 1972) (rehearing *en banc*).

We also find that the moving affidavits submitted in connection with this motion are sufficient to comply with the provisions of Rule 56(e) of the Federal Rules of Civil Procedure, despite defendants' assertions to the contrary. Rule 56(e) states in pertinent part that "[s]upporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in

4a. 15 U.S.C. §77v.

5. 15 U.S.C. §78aa.

evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein." Defendants assert that plaintiffs failed to comply with this rule in submitting an affidavit by their attorney allegedly not based on personal knowledge and a second affidavit by plaintiff H.Victor Schwimmer, who declared that the attorney's affidavit is "true." Plaintiffs' attorney responds that his affidavit was based on personal knowledge of the documents, event, and admissions in question, although his moving affidavit did not so state. Furthermore, plaintiffs' attorney argues that, in any event, the corroborative affidavit by Schwimmer passes muster under Rule 56(e), since it was based on personal knowledge.

We accept plaintiffs' attorney's statement that his affidavit was based on personal knowledge, and thus distinguish *Mercantile Nat. Bank at Dallas* v. *Franklin Life Ins. Co.*, 248 F.2d 57, 59 (5th Cir. 1957), cited by defendants, since in that case moving affidavits by attorneys were not based on personal knowledge. Rather we agree with the court in *Inglett & Co.* v. *Everglade Fertilizer Co.*, 255 F.2d 343, 349 (5th Cir. 1958) that it is permissible, though not advisable, for an attorney to present his own affidavit in support of a motion for summary judgment.[6]

First Cause of Action

Plaintiffs' first cause of action alleges, *inter alia*, that the defendant sponsor was required to register its

6. The inappropriateness of an attorney submitting an affidavit in support of a summary judgment motion is abundantly clear in the instant case, where plaintiffs' attorney's affidavit occasionally strays from a recitation of the facts to engage in argumentation and citation of legal authorities.

offering with the Securities and Exchange Comission pursuant to §5 of the Securities Exchange Act of 1933 and failed to do so. Defendants Milton, Henry and Jerome Spitz and defendant 34557 Corporation concede that their offering was not registered but argue as an affirmative defense that the offering falls within the §3(a)(11) exemption from registration since it was made by a New York "issuer" and shares were sold only to New York residents. Section 3(a)(11) exempts from registration and prospectus requirements of the 1933 Act:

> Any security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.[7]

Plaintiffs have moved to strike the defendant sponsor's affirmative defense based on Section 3(a)(11) of the 1933 Act, contending that the issuer partnership is not a "person" resident within New York, that the issuer does business outside of New York, and that some of the purchasers were nonresidents.

Plaintiffs' contention that this exemption does not apply is based initially on the conceded California residence of partner Jerome Spitz. His lack of New York residence is only dispositive if it is determined that each partner of the issuer must be a resident of the issuing state. If the rule is otherwise, however, a partnership issuer - such as the one here - will be entitled to the intrastate exemption as long as its principal place of business is in the issuing state.

7. 15 U.S.C. §77c(11) (1970)

No federal court has ruled on which theory of partnership residency should be applied for purposes of the §3(a)(11) exemption and commentators considering the subject have disagreed. Professor Louis Loss has suggested that the residence of a general partnership should be that of it principal place of business.[8] A former Associate General Counsel of the Securities and Exchange commission has suggested, however, that the residence of a general partnership should be the residences of all of its general partners.[9] While the 1933 Act does not define the term "resident," the SEC long construed the term to mean "domiciliary."[10] More recently, the SEC promulgated Rule 147, effective March 1, 1974, which sought to clarify the definition of "resident" under §3(a)(11). Under Rule 147, when an issuer is a general partnership, its residence is that of its principal place of business.[11] According to two recent commentators, this definition is merely declarative of existing law.[12]

We believe that on the basis of the above authorities, the better view is that the residence of a general partnership is that of its principal place of business. Applying that rule to the instant case, it is clear that the defendant sponsor partnership, Three Forty Five Management Co.,

8. 1 Loss, SECURITIES REGULATION 600 (2d ed. 1961) [hereinafter cited as Loss].

9. McCauley, Intratstate Securities Transactions under the Federal Securities Act, 107 U.Pa.L.Rev. 937, 948 (1959).

10. SEC Securities Act Release No. 4434, at 3 (Dec. 7, 196).

11. SEC Securities Act Release No. 5450 (Jan. 7, 1974).

12. Alberg and Lybecker, "New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions From Registration for the Sale of Securities," 74 Col.L.Rev. 622, 650 (1974).

falls within the residence requirement for a §3(a)(11) exemption, since it is conceded that its principal place of business is in New York.

Plaintiffs also challenge the defendants' claimed registration exemption on the ground that defendants were not doing business within New York State, because three of the subscription agreements for the cooperative were acknowledged outside of New York. We do not believe plaintiffs have correctly interpreted the "doing business" requirement of §3(a)(11). As Professor Loss has observed, "...the issuer's business need not be *confined* to the state in which it is resident or incorporated."[13] The mere acknowledgement of three subscription agreements outside New York State, without more, is not sufficient to give rise to the conclusion that the defendant sponsor is not doing business in New York.[13a]

Plaintiffs' third ground for challenging defendants' right to invoke the intrastate exemption is based on the contention that several of the purchasers of stock in the cooperative "were at the time of the offer or sale [of subscription agreements] or have since become, non-residents of the State of New York." (Affidavit of Charles Marks, p. 20). Whether purchasing residents must be domiciled in New York, maintain a principal residence

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13. Loss, *supra*, at 601.

13a. Plaintiffs also appear to challenge the out-of-state acknowledgment of these three subscription agreements on the ground that the intrastate exemption from registration does not apply if securities are sold to persons not resident in New York. That argument is without merit, however, since out-of-state acknowledgment of subscription agreements does not prove that the subscribers are nonresidents.

here, or merely maintain *a* residence here has not been decided by any federal court. However, plaintiffs offer no proof to show that defendants offered any shares to nonresidents, however "resident" is defined.[14] Plaintiffs present no proof that Judith Ann Taft, who allegedly sublet her apartment in New York and became a resident of London, was a nonresident at the time she purchased her shares in the cooperative. Nor have plaintiffs demonstrated that Taft's shares were transferred to a non-New York resident before the date of the closing of the sale of the apartment to the cooperative corporation. Such evidence might demonstrate that upon completion of ultimate distribution of the shares of the cooperative, they were not wholly in the hands of New York residents, in which case the intrastate exemption would not apply. *SEC* v. *Hillsborough Invest. Corp.*, 173 F.Supp 86, 88-89 (D. N.H. 1958). In addition, plaintiffs seek to prove that various tenants are not New York residents because individuals of the same name are listed in telephone directories in other states. Obviously, such "evidence" is insufficient to prove that any tenants are nonresidents of New York.

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14. While defendants have the burden of proof on the issue of whether they come within the intrastate exemption, *SEC* v. *Ralston-Purina Co.*, 346 U.S. 119, 126 (1953); *Chapman* v. *Dunn*, 414 F2d 153, 159 (6th Cir. 1969); *SEC* v. *Culpepper*, 270 F.2d 241, 246 (2d Cir. 1959); plaintiffs cannot rebut defendants- prima facie case by mere allegations. In addition, defendants have submitted affidavits of various tenants claimed by plaintiffs to be nonresidents; those affidavits demonstrate that the affiants were either domiciled in New York or maintained their principal residence here at the time they purchased shares in the cooperative.

For these reasons, we deny plaintiffs' request to strike the defendants' affirmative defense based on §3(a)(11), and hold that the defendant sponsor met the requirements of that exception and therefore was exempt from the registration provisions of the 1933 securities act. Our conclusion is buttressed by the fact that the offering here was a local financing done by a local business.[15] The offering was not made to any prospective tenant, but rather primarily to residents in the apartment. The partnership's principal place of doing business was New York and its sole purpose was to create the cooperative housing coporation in New York.

Plaintiff's first cause of action also alleges violations of §17 of the Securities Act of 1933 and §10(b) of the Securities Exchange Act of 1934.[16] Defendants are subject to liability for rescission of securities sales under these section even though they are exempt from the requirements of registration under §5 of the Securities Act of 1933. *Pawgan* v. *Silverstein*, 265 F. Supp. 898, 900 (S.D.N.Y. 1967). *See also* SEC Securities Act Release No. 4877 (Aug. 8, 1967).

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15. The legislative history of the Act supports the SEC's view that the intrastate exemption was intended to apply only to local financing which could practicably be consummated wholly within a single state where the issuer is doing business and is incorporated. See H.R. Rep. No. 85, 73d Cong., 1st Sess. 7 (1933); Op. Gen. Counsel, Securities Act Release No. 1459 (May 29, 1937); SEC Securities Act Release No. 4434 (Dec. 6, 1961).

16. Defendants maintain that it is doubtful whether plaintiffs other than plaintiff Fielder have standing to allege a claim under either Section 17(a) of the 1933 Act or Section 10(b) of the 1934 Act. We need not reach this issue, however, since it is conceded that at least one plaintiff has standing.

We deny plaintiffs' motion for summary judgment with respect to these sections of the federal securities laws because we find that there are factual issues in dispute, primarily regarding the materiality of certain alleged misrepresentations and omissions in the prospectus, offering plan and it amendments. Whether a misrepresentation or omission in a prospectus is material depends on whether it is something about which "an average prudent investor ought reasonably to be informed before purchasing the security." *Demarco* v. *Edens*, 390 F.2d 836, 840 (2d Cir. 1968), *citing* 17 C.F.R. 230.405(1).[17] And generally, the issue of materiality, "resting as it does upon the reaction of a 'reasonable man,' cannot be decided by summary judgment." *John Hopkins University* v. *Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970).

In the instant case, plaintiffs allege that the sponsor's offering statement contains numerous omissions of patently material facts. Plaintiffs maintian that the materiality of the alleged omissions is conclusively demonstrated by the fact that they are purportedly required to be set forth in an offering statement by §352-e of the General Business Law of New York State.

Specifically, plaintiffs allege that the sponsor's offering statement contained, *inter alia*, the following ommissions: (1) failure to state that defendant Jerome Spitz was a resident of California, thus apprising

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17. These cases involve liability under §12(2) of the Securities Act of 1933 based upon the existence of material omissions referred to therein. The language of §12(2), however, is similar to that of §17(a)(2) of the Securities Act of 1933 and Rule 10b-5(2) of the General Rules and Regulations under the Securities Exchange Act of 1934.

prospective purchasers that the provisions of the federal securities laws would apply to their transaction; (2) failure to state the profits of each of the partners from the sale of shares in the cooperative, although §352-e(1)(b) of the General Business Law allegedly required such information; (3) failure to state the amount of depreciation of the apartment building, although the same section of the General Business Law requires that the offering statement or prospectus include "the basis, rate and method of computing depreciation;" and (4) failure to include in the third amendment to the offering statement a Letter of Adequacy with respect to the Projected Schedule of Expenses for the First Year of Operation.

Defendants vigorously dispute the importance of these omissions. They contend that their failure to state the residence of Jerome Spitz is immaterial, since the intrastate exemption from registration applies as long as the sponsor partnership's principal place of business is in New York, They also point out that under the regulation extablished under §352-e of the General Business Law, the profits of the sponsors need not be stated where the promoter has held continuous control of ownership in the apartment for three years prior to the proposed first offering of cooperative apartments. They maintain they they were not obligated to state their profits since they had continuously controlled the ownership of the apartment building for the requisite three-year period before the offering commenced. Defendants also contend that their failure to state the amount of depreciation was not material on the ground that they indicated in the cooperative plan that depreciation was not a tax deductible item, and was thus of minimal interest to prospective purchasers of securities. Similarly, defendants concede that a Letter of Adequacy was not contained in the third amendment to the offering statement, but maintain that the Letter of Adequacy accompanying the original cooperative plan was sufficient to apprise tenants of the first year's schedule of expenses, and that subsequent amendments reflected significant changes in projected first-year operating expenses.

Since the materiality of these omissions is in dispute, we deny plaintiffs' motion for summary judgment with respect to their federal causes of action.[18]

Third Cause of Action

Plaintiffs' third cause of action alleges that the offering statement, prospectus or plan and amendments thereto violated §352-e(1)(a) and (b) of New York's General Business Law by omitting required material information and by making material misrepresentations. Section 352-e(1)(a) makes it illegal for persons and partnerships, *inter alia*, to make or take part in a sale or offering of securities in New York State, including cooperative interests in realty,

> unless and until there shall have been filed with the department of law, prior to such offering, a written statement or statements, to be known as an "offering statement" or "prospectus" concerning the contemplated offering which shall contain the information and representations required by paragraph (b) of this subdivision. . .

18. We also note that Justice Harry B. Frank, in denying a similar motion for summary judgment in a related pending state action, found that there were numerous factual issues in dispute. It is true, however, that he focussed on factual issues involving misrepresentations rather than omissions. *Grenader* v. *Lefkowitz*, (N.Y.City Sup.Ct., Sept. 25, 1972).

Paragraph (b) then sets forth a comprehensive list of items to be included in offering statements filed with the department of law. Those items, as well as additional information which may be required by rules and regulations prescribed by the attorney general, are designed to "afford potential investors, purchasers and participants an adequate basis upon which to found their judgment and shall not omit any material fact or contain any untrue statement of a material fact."

In support of this cause of action, plaintiffs maintain that the alleged material misrepresentations and omissions which purportedly violated the federal securities laws also demonstrate a violation of §352-e (1)(a) and (b) of the General Business Law. Since we have denied plaintiffs' motion for summary judgment on the federal causes of action -- predicated upon violations of the state securities law -- *a fortiori*, we must deny their motion on this pendent state cause of action. As with the federal causes of action, we conclude that defendants' alleged misrepresentations and omissions of information in their prospectus and offering statement were not so clearly material so as to entitle plaintiffs to judgment as a matter of law.[19]

Fourth Cause of Action

The third amendment to the offering statement provided that the plan would not be declared effective unless 51 percent of the tenants had executed subscription agreements "by May 16, 1972." Plaintiffs contend that this term should be construed to cover the period up

19. See note 18, *supra*.

to and including May 15, 1972, and, when so construed, the whole cooperative plan must fail, since the requisite number of signatures was not obtained until May 16, 1972.

Defendants characterize plaintiffs' fourth cause of action as "absurd," and contend that it is supported only by argument and statements of belief. In addition, Joel Arnold, an attorney who helped draft the disputed language, states in an affidavit on behalf of the defendants, that the original expiration date of March 16, 1972 was extended by two months until May 16, 1972. According to Arnold, the intent of the drafters was to extend the deadline until May 16, 1972 at 11:59 p.m. Plaintiffs counter that any ambiguities in language should be construed against the party which drafted them. 17 Am.Jur.2d 690. We believe, however, that defendants, with the Arnold affidavit, have raised a question of fact regarding the intent of the parties who drafted the offering statement. This question should be resolved by evidence adduced at trial, not by construing any ambiguities in language against the party which drafted them. Since the question of the intent of the parties is one of fact, *United States* v. *Kansas Gas and Electric Co.*, 287 F.2d 601 (10th Cir. 1961), we deny plaintiffs' motion for summary judgment on their fourth cause of action.

For the reasons indicated, plaintiffs' motion for partial summary judgment is denied in all respects.

We also grant leave to plaintiffs Susanne Buchner and Davidson Taylor to discontinue their participation in this action.

SO ORDERED

CHARLES STEWART
United States District Judge

Dated: New York, N.Y.
March 5, 1975.

Opinion of the District Court On Plaintiffs' Motion for Renewal and Reargument

MAX GRENADER et al.,

Plaintiffs,

v.

MILTON SPITZ et al.,

Defendants.

No. 72 Civ. 3784
United States District Court
S.D. New York
Sept. 29, 1975

Charles Marks, New York City, for plaintiffs, Max Grenader, Roger W. Ach II, Ann Fielder, John Gerstad, Lee Gerstad, Celia Gordon, P. Benjamin Kaufman, Dorothy Kimball, Gertrude Landau, Horace Mills, Adrienne Minassian, Sylvia Jane Morrison, Cora Muller-Thym, H. Victor Schwimmer, Frances Stein, Marion Terres, John Terres, Masie G. Wilkinson and Olga Rudnyansky.

Kevin P. Hughes, Weil, Gotshal & Manges, New York City for defendants, Milton Spitz, Henry Spitz and Jerome Spitz, d/b/a Three Forty Five Management Co., and 34557 Tenants Corp.

Robert Barandes, Barandes, Rabbino & Arnold, New York City, for defendants, Bernard Cooper, Robert Julius, Jerry V. Shields, Jr., William L. Livingstone, Joel Key Rice, Frank Moorman, Judith Ann Taft, Gloria Lister a/k/a Gloria Hahn, Sylvia Spitz, Ernest Borkland, James Daniel Cotton, Bobby Mitchel and S. Mercer Moorman.

STEWART, DISTRICT JUDGE:

Plaintiffs move for renewal and reargument of part of their prior motion for partial summary judgment on the ground that the securities here in issue were not entitled to an intrastate exemption from registration under §3(a)(11) of the Securities Act of 1933 because of the nonresidence of three of the four partners of the defendant partnership Three Forty Five Management Co. Plaintiffs also allege various other oversights in this court's memorandum decision of March 6, 1975, in which we held that the residence of a partnership for purposes of the intrastate exemption was the locus of its principal place of business, and not the residence of its individual partners.

While this motion was pending, the Supreme Court decided *United Housing Foundation* v. *Forman*, 43 U.S.L.W. 4742 (U.S. June 16, 1975). The *Forman Court* held that the shares of stock in a state-subsidized nonprofit housing cooperative were not "securities" or "investment contracts" within the purview of the federal securities laws. Believing that this decision might be applicable to the instant case, we requested that the parties brief the issue of whether shares of stock in the privately sponsored housing cooperative in the instant

case come within the reach of the federal securities laws.

For the reasons indicated, we reaffirm our initial decision regarding the entitlement of the defendant partnership to the intrastate registration exemption. We also conclude that *Forman* is distinguishable from the instant case, and that the shares of stock at issue here fall under the regulation of the federal securities laws.

1. Motion for reargument

In the memorandum decision of March 6, we concluded that the residence of the defendant partnership Three Forty Five Management Co. was that of its principal place of business - New York - even though several of its partners were nonresidents. Although our earlier decision did not expressly so state, we effectively held that the defendant partnership sponsor was a control person of 34557 Tenants Corp., the issuer of the stocks of the cooperative plan. Under §2(11) of the Securities Act of 1933, an issuer is defined to include "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." Since it was clear that the defendant pertnership exercised a significant degree of control over the issuer apartment corporation, we considered it as an issuer also, and accordingly determined that it was a New York "resident." We reaffirm that conclusion now. Plaintiffs have presented no new evidence regarding our determination that the principal place of business is the residence of a general partnership for purposes of the exemption from registration. Plaintiffs now ask us to conclude that the individual partners were also control persons. They argue that three of the four Spitz brothers

are out-of-state residents. If they are considered "control persons," then we must consider them as issuers. in that event, one or more of the "issuers" would be non-residents, and thus defendants would not be entitled to the §3(a)(11) intrastate exemption. We cannot agree with this line of analysis. The individual partners were not "control persons," since they did not directly or indirectly control the issuer. The only plausible argument raised by plaintiffs is that Milton Spitz was a "control person" since he was appointed as an "attorney-in-fact" in 1971 to act on behalf of Three Forty Five Management Company, a predecessor to defendant Three Forty Five Management Co. This appointment is insufficient to convince us that Milton Spitz was a control person. That he was an agent for his brothers does not mean he controlled them. Since plaintiffs have not indicated that Milton Spitz or any other one brother controlled the defendant partnership or its predecessor, we conclude that none of them are control persons.

Plaintiffs also maintain that this court should have applied the "doing business" requirement in SEC Rule 147(c)(2)(iii) with respect to the "issuer" partnership. As defendants correctly note, plaintiffs' argument on this point is entirely misplaced. We cited Rule 147 in our earlier memorandum only for the conclusion that it was declarative of existing law with respect to the definition of the residence of a general partnership for purposes of the intrastate exemption from registration. Moreover, to the extent *SEC* v. *McDonald Investment Co.*, 343 F.Supp. 343 (D. Minn. 1972) and *SEC* v. *Truckee*, 157 F.Supp. 824 (S.D. Cal. 1957), cited by plaintiffs, reflect the law on the

doing business requirement, they are distinguishable from the instant case.

Plaintiffs also assert that this court erred in holding defendants entitled to the intrastate exemption because defendants did not cross-move for summary judgment. Nevertheless, since defendants met the requisite burden of proof by establishing that there were no factual issues and that they were entitled to prevail as a matter of law, we found such a cross-motion to be unnecessary. 6 Moore *Federal Practice* ¶56.12 at 2241-2246 (2d ed. 1974).

Plaintiffs' other contentions on this motion for reargument are summarily dismissed, since they are without merit and fail to raise any new issues.

2. The Forman decision

The *Forman Court* concluded that shares of stock in the publicly sponsored housing cooperative project known as Co-op City were neither "stocks" nor "invest contracts" within the meaning of the federal securities laws. The Court noted that economic realities - not mere labels - must determine whether particular shares are "stocks" or "investment contracts." The Court then listed several factors common to most stocks which it found lacking in the Co-op City shares: voting rights in proportion to the number of shares owned, appreciation in value, a right to receive dividends, negotiability, and the ability to pledge or bypothecate shares. In most of these respects, the shares in the instant case are more like traditional shares of stock than those in *Forman*. Apartment owners here have voting rights in proportion to the number of shares they own, and the number of shares owned is different for each apartment. Unlike the

shares in Co-op City (which must generally be resold at purchase price), the shares here may be and have been sold at a profit. For example, one tenant purchased shares for $13,700 and resold them for about $40,000, while two others bought an apartment at $14,500 and resold it for approximately $60,000. Although the shares are not freely transferable - transfers are subject to approval by the Board of Directors or the Managing Agent - they are more freely transferable than the Co-op City Shares. The Supreme Court noted in *Forman* that the motive for purchase of the Co-op City shares was housing, not investment for profit. Here, by contrast, tenants purchased shares with the dual motives of obtaining housing and realizing a profit on their investments. Taking these differences into account, we think that the shares in the privately sponsored cooperative here fall within the reach of the federal securities laws.

The *Forman Court* also concluded that the Co-op City shares were not investment contracts since there was not "a reasonable expectation of profits to be derived from the entreprenurial or managerial efforts of others." 43 U.S.L.W. at 4747. Here the situation is different. Tenants purchasing shares in the 345 East 57th Street building sought both housing and profits, the profits to be derived from the managerial efforts of the sponsor and the apartment corporation. To the extent that they utilized their resources and skills in efficiently managing the building, maintaining it in good condition, and attracting desirable tenants, they enabled the tenants to obtain profits as a result of the appreciation in their property. Accordingly, we believe that the shares here

also constitute investment contracts under the federal securities laws.

For the reasons indicated, we think our conclusion in *1050 Tenants Corporation* v. *Jackobson*, 365 F.Supp. 1171 (S.D.N.Y. 1974) *aff'd* 503 F.2d 1375 that shares in privately sponsored cooperatives are "stocks" and "investment contracts" under the federal securities laws is still proper and applies here.

Since we believe there are controlling questions of law regarding (1) whether the intrastate exemption under §3(a)(11) of the Securities Act of 1933 is available for the securities in the case at bar, and (2) whether the securities here come within the purview of the federal securities laws and, since we believe an immediate appeal from this order may materially advance the ultimate termination of this litigation, we certify these questions to the Court of Appeals in accordance with 28 U.S.C. §1292(b).

SO ORDERED.

/s/CHARLES STEWART
United States District Judge

Dated: New York, N. Y.
September 26, 1975.

Appendix C

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-eighth day of April, one thousand nine hundred and seventy-six.

Present:

Hon. WILLIAM H. MULLIGAN,
Hon. MURRAY I. GURFEIN, Circuit Judges,
Hon. EDWARD R. NEAHER, District Judge.

75-7592
75-7601

Max Grenader, Roger W. Ach II, Ann Fielder, John Gerstad, Lee Gerstad, Celia Gordon, P. Benjamin Kaufman, Dorothy Kimball, Gertrude Landau, Horace Mills, Adrienne Minassian, Sylvia Jane Morrison, Cora Muller-Thym, H. Victor Schwimmer, Frances Stein, Marion Terres, John Terres, Masie G. Wilkinson, Olga Rudnyansky, Madeline Schainuck.

Plaintiffs-Appellants-Appellees,

v.

Milton Spitz, Henry Spitz and Jerome Spitz, d/b/a Three Forty Five Management Co.,

Defendants-Appellees-Appellants.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the order of said District Court be and it hereby is reversed and that the complaint be and it hereby is dismissed in accordance with the opinion of this Court with costs to be taxed against plaintiffs-appellants-appellees.

A. DANIEL FUSARO
Clerk

By Vincent A. Carlin
Chief Deputy Clerk

Statutes, Rules and Regulations Involved

The statutes involved in this case are §§2(1),(2),(4), 3(a)(11), 5, 12, 15, 17, 22(a), 24 and 26 of the Securities Act of 1933 (15 U.S.C. §§77b(1), (2), (4) 77c(a)(ll), 77e, 77l 77q, 77v(a), 77x and 77z); §§3(a)(8), (10), (13), 10(b), 15, 20, 27, 29(b) and 33 of the Securities Exchange Act of 1934 (15 U.S.C. §§78c(a)(8), (10), (13), 78j(b), 78t, 78aa, 78xx(b) and 78gg); New York General Business Law, §352-e; and New York Business Corporation Law §510, which provide, in pertinent part, as follows:

§2 Securities Act of 1933, 15 U.S.C. §77b

DEFINITIONS

Sec. 2. When used in this title, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing, agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

* * *

(2) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any incorporated organization, or a government or political subdivision thereof. As used in this paragraph the term "trust" shall include only a trust where the interest or interests of the beneficiary or beneficiaries are evidenced by a security.

* * *

(4) The term "issuer" means every person who issues or proposes to issue any security; except that with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in any unincorporated investmnet trust not having a board of directors (or persons performing similar function) or of the fixed, restricted management, or unit type, the term "issuer" mean the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is or is to be used; and excep that with respect to fractional undivided interests in

oil, gas, or other mineral rights, the term "issuer" means the owner of any such right or of any interest in such right (whether whole of fractional) who creates fractional inbterests therein for the purpose of public offering.

§3(a)(11) Securities Act of 1933, 15 U.S.C. §77c

EXEMPTED SECURITIES

Sec. 3. (a) Except as hereinafter expressly provided the provisions of this title shall not apply to any of the following classes of securities:

* * *

(11) Any security which is a part of any issue offered and sold only to persons resident within a single State of Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State of Territory.

§5 Securities Act of 1933, 15 U.S.C. §77e

PROHIBITIONS RELATING TO INTERSTATE COMMERCE AND THE MAILS

Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of

transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been field under this title unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of sub-section (a) of section 10.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

§12 Securities Act of 1933, 15 U.S.C. §77l

CIVIL LIABILITIES ARISING IN CONNECTION WITH PROSPECTUSES AND COMMUNICATIONS

Sec. 12. Any person who—

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation of communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission

shall be liable to the person purchasing such security from him, who, may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

§15 Securities Act of 1933, 15 U.S.C. §77o

LIABILITIES OF CONTROLLING PERSONS

Sec. 15. Every person who, by or through stock ownership, agency, or otherwise, or who pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under section 11 or 12, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

§17 Securities Act of 1933, 15 U.S.C.§77q

FRAUDULENT INTERSTATE TRANSACTIONS

Sec. 17. (a) It shall be unlawful for any person in the offer or sale of sany securities by the use of any means or instruments of transportration or communication in interstate commerce or by the use of the mails, directly or indirectly -

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section.

§22(a) Securities Act of 1933, 15 U.S.C. §77v(a)

JURISDICTION OF OFFENSES AND SUITS

Sec. 22. (a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an

inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

§24 Securities Act of 1933, 15 U.S.C. §77x

PENALTIES

Sec. 24. Any person who willfully violates any of the provisions of this title, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

§26 Securities Act of 1933, 15 U.S.C. §77z

SEPARABILITY OF PROVISIONS

Sec. 26. If any provision of this Act, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of this Act, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

§3(a) Securities Exchange Act of 1934, 15 U.S.C. §78c(a)

DEFINITIONS AND APPLICATION OF TITLE

Sec. 3. (a) When used in this title, unless the context otherwise requires—

* * *

(8) The term "issuer" means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in any unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of the depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or

participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exhange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exlusive of days of grace, or any renewal thereof months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

* * *

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

§10(b) Securities Exchange Act of 1934, 15 U.S.C. §78j(b)

REGULATION OF THE USE OF MANIPULATIVE AND DECEPTIVE DEVICES

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§15 Securities Exchange Act of 1934, 15 U.S.C. §78o

OVER-THE-COUNTER-MARKETS

Sec. 15. (a)(1) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

(2) The Commission may by such rules and regulations or orders as it deems necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions or for specified periods, exempt from paragraph (1) of this subsection any broker or dealer or class of brokers or dealers specified in such rules, regulations, or orders.

§20 Securities Exchange Act of 1934, 15 U.S.C. §78t

LIABILITIES OF CONTROLLING PERSONS

Sec. 2 (a) Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such contlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly indirectly induce the act or acts constituting the violation or cause of action.

(b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.

(c) It shall be unlawful for any director or officer of, or any owner of eny securities issued by, any issuer required to file any document, report, or information under this title or any rule or regulation thereunder without just cause to hinder, delay, or obstruct the making or oling of any such document, report, or information.

§27 Securities Exchange Act of 1934, 15 U.S.C. §78aa

JURISDICTION OF OFFENSES AND SUITS

Sec. 27. The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall

have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

§29(b) Securities Exchange Act of 1934, 15 U.S.C. §78cc(b)

VALIDITY OF CONTRACTS

• • •

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or

regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided*, (A) that no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

§33 Securities Exchange Act of 1934, 15 U.S.C. §78gg

SEPARABILITY OF PROVISIONS

Sec. 33. If any provision of this act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of the act, and the application of such provision to persons or circumstances other than those as to which it islelld invalid, shall not be affected those as to which it is held invalid, shall not be affected thereby.

New York General Business Law, §352-e

§352-e. Real estate syndication offerings

1. (a) It shall be illegal and prohibited for any person, partnership, corporation, company, trust or association, or any agent or employee thereof, to make or take part in a public offering or sale in or from the state of New York of securities constituted of participatio interests or investments in real estate, mortgages or leases, including stocks, bonds, debentures, evidences of interest or indebtedness, limited partnership interests or other security or securities as defined in section three hundred fifty-two of this article, when such securities consist primarily of participation interests or investments in one or more real estate ventures, including cooperative interests in realty, unless and until there shall have been filedith the department of law, prior to such offering, a written statement or statements, to be known as an "offering statement" or "prospectus" concerning the contemplated offering which shall contain the information and representations required by paragraph (b) of this subdivision unless the security offering is exempted hereunder or under section three hundred fifty-nine-f, subdivision two, of this article by rule or action of the attorney general. The term "real estate" as used in the paragraph shall not include mineral, oil or timber leases or properties, or buildings, structures, land or other realty housing or containing business offices or industry, owned or leased by the issuer, where the issuer is not primarily engaged in the business of buying and selling such building or other realty or leases or interests therein. The circulation or dissemination of a non-firm offer (including circulation or dissemination of a preliminary

prospectus pursuant to section ten (b) of the securities act of nineteen hundred thirty-three, and the rules thereto appertaing) shall not constitute making or taking part in a public offering within the meaning of this section.

(b) The detailed terms of the transaction; a description of the property, the nature of the interest, and how title thereto is to be held; the gross and net income for a reasonable period preceding the offering where applicable and available; the basis, rate and method of computing depreciation; a description of major current leases; the essential terms of all mortgages; the names, addresses and business background of the principals involved, the nature of their fiduciary relationship and their financial relationship, past, present and future, to the property offered to the syndicate and to those who are to participate in its management; the interests and profits of the promoters, offerors, syndicate organizers, officers, directors, trustees or general partners, direct and indirect, in the promotion and management of the venture; all restrictions, if any, on transfer of participants' interests; a statement as to what stock or other security involved in the transaction, if any, is non-voting; a statement as to what disposition will be made of the funds received and of the transaction if not consummated, which statement shall represent that all moneys received from the sale of such securities until actually employed in connection with the consummation of the transaction as therein described, shall be kept in trust and that in the event insufficient funds are raised through the offering or otherwise to effectuate the purchase or purchases or other consummation of the contemplated transaction, or that the intended acquisition shall not be completed for any other reason or reasons, then such moneys, less such amounts actually employed in connection with the consummation of the trasaction, shall be fully returned to the investor; which of the securities offered are unsecured; clearly distinguish between leasehold and fee ownership, between fact and opinion; a commitment to cubmit annual reports to all participants, including an annual balance sheet and profit and loss statement certified by an independent certified public accountant; clearly distinguish between those portions of promised distributions which are income and those which are a return of principal or capital; and such additional information as the attorney general may prescribe in rules and regulations promulgated under subdivision six hereof as will afford potential investors, purchasers and participants an adequate basis upon which to found their judgment and shall not omit any material fact or contain any untrue statement of a material fact.

New York Business Corporation Law §510

§510. Dividends or other distributions in cash or property

(a) A corporation may declare and pay dividends or make other distributions in cash or its bonds or its property, including the shares or bonds of other corporations, on its outstanding shares, except when currently the corporation is insolvent or would thereby be made insolvent, or when the declaration, payment or distribution would be contrary to any restrictions contained in the certificate of incorporation.

(b) Dividends may be declared or paid and other distributions may be made out of surplus only, so that the net assets of the corporation remaining after such declaration, payment or distribution shall at least equal the amount of its stated capital; except that a corporation engaged in the exploitation of natural resources or other wasting assets, including patents, or formed primarily for the liquidation of specific assets, may declare and pay dividends or make other distributions in excess of its surplus, computed after taking due account of depletion and amortization to the extent that the cost of the wasting or specific assets has been recovered by depletion reserves, amortization or sale, if the net assets remaining after such dividends or distributions are sufficient to cover the liquidation preferences of shares having such preferences in involuntary liquidation.

The Rules and Regulations involved in this case are Rule 235, General Rules and Regulations Under the Securities Act of 1933, 17 C.F.R. 230.235; Rules 10b-5 and 15a-2, General Rules and Regulations Under the Securities Exchange Act of 1934, 17 C.F.R. §§240.10b-5, 240.15a-2; New York City Rent Control Regulations §55; New York City Rent Stabilization Code, §61; and Rule 54 (b) and (c) Federal Rules of Civil Procedure which provide, in pertinent part, as follows:

Rule 235, General Rules and Regulations Under the Securities Act of 1933, 17 C.F.R. 230.235

Rule 235. Exemption of Securities of Cooperative Housing Corporations

(a) Stock or other securities representing membership in any cooperative housing corporation shall be exempt from registration under the Act if the terms and conditions of this rule are met. The term "cooperative housing corporation" as used herein means a corporation each of whose members is entitled, solely by reason of his membership in such corporation-

(1) to occupy for dwelling purposes a house, or an apartment in a building, owned or leased or to be owned or leased, by such corporation; or

(2) to purchase a dwelling constructed or to be constructed by such corporation.

(b) Such corporation shall not be or intend to be engaged in any business or activity other than the ownership, leasing, management or construction of residen-

tial properties for its members, except to the extent that such business or activity is incidental to the ownership, leasing, management or construction of such residential properties.

(c) The securities shall be issued only in connection with the sale or lease of dwelling units to persons who are or thereupon become members of the corporation and shall be transferable by the purchasers only in connection with the transfer of such dwelling units or leases to other persons who are or thereupon become such members.

(d) The aggregate offering price of all securities of the corporation offered pursuant to this rule during any twelve-month period shall not exceed $300,000, including any unsold securities initally offered prior to the beginning of such period.

(e) The aggregate offering price of securities offered pursuant to this rule shall be computed upon the basis of the price at which the securities are to be sold to members or, if such price is not separately specified, upon the basis of the par or stated value of the securities to be offered.

Rule 10b-5, General Rules and Regulations Under Securities Exchange Act of 1934, 17 C.F.R. 240.10b-5

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Rule 15a-2, General Rules and Regulations Under the Securities Exchange Act of 1934, 17 C.F.R. §240.15a-2

Rule 15a-2. Exemption of Certain Securities of Cooperative Apartment Houses From Section 15(a)

Shares of a corporation which represents ownership, or entitle the holders thereof to possession and occupancy, of specific apartment units in property owned by such corporations and organized and operated on a cooperative basis are hereby exempted from the operation of

section 15(a) of the Act, when such shares are sold by or through a real estate broker licensed under the laws of the political subdivision in which the property is located.

New York City Rent Control Regulations, §55

Applicable Provisions of Section 55. Occupancy by Landlord or immediate family.

a. A certificate shall be issued where the landlord seeks in good faith to recover possession of a housing accommodation because of immediate and compelling necessity for his own personal use and occupancy, or for the use and occupancy of his immediate family; provided, however, that (1) where the housing accommodation is located in a building containing twelve or less housing accommodations and the landlord does not reside in the building, or (2) is a housing accommodation located in a structure or premises owned by a cooperative corporation or association which is allocated to an individual proprietary lessee and the landlord does not reside in the building, or (3) is a housing accommodation or unit in a property submitted to the provisions of the Condominium Act and the landlord does not reside in the building and the landlord seeks in good faith to recover possession for his own personal use and occupancy, an immediate and compelling necessity need not be established. As used in this paragraph, the term "immediate family" includes only a son, daughter, stepson, stepdaughter, father, mother, father-in-law, or mother-in-law.

* * *

c. (1) In the case of a housing accommodation in a structure or permises owned by a cooperative corporation or association, a certificate shall be issued by the Administrator to a purchaser of stock where (a) the tenant originally obtained possession of the housing accommodation by virtue of a rental agreement with the

tenant-owner; or (b) the stock was acquired by the purchaser prior to July 1, 1955 and more than two years prior to the date of filing of the application; or (c) the stock was acquired by the purchaser on or after July 1, 1955 and more than two years have expired since the date of filing of the notice of sale with the Local Rent Office or the District Rent and Rehabilitation Office, as hereafter provided in paragraph c(3)(e) of this section; or (d) the stock was acquired less than two years prior to the date of filing of the application and on that date stock in the cooperative has been purchased by persons who are tenant-owners of at least 80 percent of the housing accommodations in the structure or premises and are entitled by reason of stock ownership to proprietary leases of housing accommodations in the structure or premises; or (e) the cooperative was organized and acquired its title or leasehold interest in the structure or premises before February 17, 1945 and on that date stock in the cooperative allocated to 50 percent or more of the housing accommodations in the structure or premises was held by individual tenant-owners, who are or whose assignees or sub-tenants are in occupancy of such housing accommodations in the structure or premises at the date of the filing of the application.

(2) No certificate of eviction shall be issued under paragraph c(1) of this Section, unless the applicant shall establish that he has complied with the requirements of paragraphs a and d of this section; provided, however, that where the applicant seeks to recover possession for his own personal use, he need not establish an immediate and compelling necessity.

(3) No certificate of eviction shall be issued under paragraph e(1) of this section, except as provided in paragraph (c)4 thereof, unless the applicant shall also establish that the cooperative corporation or association was complied with the following requirements:

(a) On the date the cooperative plan was first presented to the tenants, each tenant in occupancy of a controlled housing accommodation in the

premises was furnished with a copy of the plan and notified in writing that he had the exclusive right for a period of 60 days to purchase the stock allocated to his housing accommodation at the specified price, and that the plan would not be declared effective, unless on or before December 31, 1955 or within 6 months from the time the cooperative plan was presented to such tenants, whichever date is later, stock in the cooperative had been sold in good faith without fraud or duress, and with no discriminatory repurchase agreement or other discriminatory inducement, to at least 35 percent of the tenants in occupancy of controlled housing accommodation at the time of the presentation of the plan. Housing accommodations vacant on the date the plan is presented, or subsequently vacated, shall not be included in the computation of the 35 percent requirement, except when the vacant housing accommodation is purchased for personal occupancy by a tenant of a controlled housing accommodation.

(b) Subsequent to the date the cooperative plan had been declared effective, the tenants of controlled housing accommodations had been served with a written notice that the plan had been declared effective, setting forth the terms of sale and the names of the tenants of the controlled housing accommodations who had purchased the stock allocated to their own housing accommodations or to vacant housing accommodations and the names and addresses of other purchasers of vacant housing accommodations; and that the tenants of controlled housing accommodations who had not as yet purchased still had the exclusive right for a period of 30 days from the date of service of the notice, to purchase the stock allocated to their housing accommodations on the terms previously offered to the tenants; except where (1) the cooperative plan had been declared effective prior to July 1, 1955, and (2) prior to that date the tenant of a controlled

housing accommodation in the premises had received written notice or notices that for a period of not less than 30 days he had the right to purchase the stock allocated to his housing accommodations at the price and terms specified in said plan, and (3) on July 1, 1955 such stock was held or was thereafter reacquired by the cooperative or by a sponsor, nominee of the cooperative or by any other person associated with the formulation of the plan, and (4) such stock was offered after July 1, 1955 for sale for personal occupancy at the same or different terms than previously offered to the tenant of such controlled housing accommodation, the latter was given a written notice of the offer to sell and the right for a period of 30 days to purchase the stock on the terms specified in such offer.

(c) Within 10 days from the date of service of the notice provided by paragraph c(3)(b) of this section, the cooperative has filed with the Local Rent Office or District Rent and Rehabilitation Office having jurisdiction at the time, either under the State Rent or under these Regulations as the case may be, a copy of the cooperative plan; a copy of the first notice served upon all tenants of controlled housing accommodations; a copy of the notice required by paragraph c(3)(b) of this section, and a statement, duly verified by an officer of the cooperative and where the sale was made on or after July 1, 1955, a statement duly verified by each purchaser, that the sales had been made in good faith pursuant to the terms set forth in the cooperative plan without fraud or duress and with no discriminatory repurchase agreement or other discriminatory inducement or whether for personal occupany by the purchaser. A duplicate set of the above specified papers shall also be kept available in the building for inspection by any tenant of controlled housing accommodations or his authorized representative.

(d) In the event that the stock allocated to a controlled housing accommodation shall be offered

for sale by the cooperative, it sponsor, nominees or other persons associated with the formulation of the plan, to a purchaser in good faith for his personal occupancy at terms more favorable than those previously offered to the tenant of such controlled housing accommodation, the latter must first be given a written notice of the new terms and 15 days within which to elect to purchase stock at such new terms.

(e) Within 10 days after any sale or resale of stock subsequent to the effective date of the plan, all tenants who had not yet purchased had been served with written notice by the cooperative setting forth the names and addresses of each of the purchasers, the designation of the housing accommodations, and in those cases where the stock had been sold for personal occupancy of the purchaser, the terms of the sales. Copies of these notices, together with proof of service upon each such tenant, must be filed with such Local Rent Office or District Rent and Rehabilitation Office, as the case may be, within 5 days of the date of service. Copies of these notices shall also be kept available in the building for inspection.

(4) Where the cooperative plan was declared effective prior to July 1, 1955, the Administrator shall issue a certificate of eviction to a purchaser who acquired the stock prior to July 1, 1955, if he finds that the requirements of the former Section 55(3) of the State Rent and Eviction Regulations, as in effect immediately prior to July 1, 1955, have been met and that the purchaser had served the tenant of the controlled housing accommodation before December 31, 1955, with a written notice setting forth the name and address of the purchaser, designation of the housing accommodation and the terms of the sale. A copy of this notice, together with proof of service upon such tenant, must be filed with such Local Rent Office within 5 days of the date of service. Where, however, stock allocated to a controlled housing

accommodation occupied by a tenant has not in fact been sold prior to July 1, 1955 to a purchaser in good faith for personal occupancy, no certificate of eviction shall be issued unless such tenant had been afforded the rights conferred by paragraph c(3)(b),(c),(d) and (e) of this section. The cooperative must file all documents required by such paragraph c(3)(b),(c),(d) and (e) no later than December 31, 1955 or such later as is applicable.

(5) As used herein, the term "tenant-owner" includes only (a) a person who purchased the stock allocated to a vacant housing accommodation excluding, however, any housing accommodations which had been vacated after the filing of an application for a certificate of exiction or an order of sub-division pursuant to these Regulations within the one-year period preceding the presentation of the cooperative plan to the tenants; or (b) a person who while he was a tenant in occupancy in the building purchased the stock allocated to his housing accommodation; or (c) a person who purchased the stock allocated to a housing accommodation which was occupied by a tenant who obtained his possession from said purchaser of the stock; or (d) a person who purchased the stock allocated to a housing accommodation from an owner of such stock who was in occupancy of such housing accommodation; or (e) a person who purchased the stock allocated to a housing accommodation while it was occupied by a tenant and which thereafter became vacant after voluntary removal by the tenant.

(6) As used herein the term "housing accommodation" shall not include servants' rooms which are non-housekeeping and located in the service portion of the building or apartments not subject to these Regulations; and the term "tenant" shall not include the persons occupying such servants' rooms or apartments not subject to these Regulations.

(7) As used herein, the term "stock" shall also include other evidence of interest in the cooperative corporation or association with the right to possession of a housing accommodation by virtue of a proprietary lease or otherwise.

(8) As used herein, the term "cooperative corporation or association" shall also include the sponsor of a cooperative plan.

(9) Where a cooperative plan and any amendments thereof presented to the tenants of controlled housing accommodation is not declared effective and filed with the Local Rent Office or District Rent and Rehabilitation Office, as the case may be, pursuant to paragraph c(3)(b) and (c) of this section, a period of 18 months from the date of the presentation of the first plan must elapse before another cooperative plan may be presented to the tenants of the structure.

d. Where the landlord purchased and thereby acquired titled to the premises on or after September 17, 1947, no certificate shall be issued under this section unless the landlord on or before the date of the filing of the application has made a payment or payments totaling at least 20 percent of the purchase price or the assessed valuation of the premises, whichever is the greater; provided, however, that where the Administrator finds (1) that equivalent accommodations are available for rent into which the tenant can move without substantial hardship or loss, or (2) that undue hardship would result to the landlord a certificate may be issued although less than 20 percent has been paid. The requirements of this paragraph d shall not apply where the landlord is a former member of the armed forces of the United States of America who obtained a loan for use in purchasing housing accomodation guaranteed in whole or part by the Administrator of Veterans' Affiars.

New York City Rent Stabilization Code, §61,
In Effect in September 1971

Section 61. Converting to a Cooperative or Condominium Form of Ownership—

An owner of a structure containing dwelling units subject to this Code may refuse to renew leases for such dwelling units when:

1. The Attorney General of the State of New York has accepted for filing an offering Plan to convert the building to cooperative or condominium ownership, and

2. The owner has presented the offering Plan to the tenants in occupancy, and

3. The owner has filed a copy of the accepted offering Plan with the Housing and Development Administration and

4. The Plan provides

(a) The Plan will not be declared effective by the Owner (Sponsor) unless and until 35% of the tenants then in occupancy have agreed to purchase their dwelling units or the stock entitling them to proprietary leases for their dwelling units with no discriminatory repurchase agreement or other discriminatory inducement.

In establishing a base for computing the required 35%, all residential apartments in the building shall be included, except those that were vacant and not under lease at the time of the presentation of the Plan, and, in computing the 35% requirement the following shall apply:

(i) All purchases by occupants who were in possession at the time of the presentation of the Plan shall be included;

(ii) All purchases of apartments that became vacant after the Plan was presented will be included;

(iii) A purchasing tenant residing in the Building who agrees to purchase the shares allocated to another apartment in the Building, vacant at the time the Plan is declared effective, will be included;

(iv) A purchase by a tenant residing in the Building who agrees to purchase the shares

allocated to an apartment occupied by another tenant will be included if that other tenant has agreed to purchase the first tenant's apartment or a vacant apartment;

(v) Purchases by the tenant of record of a subleased apartment will be included; sub-tenants will have no right to purchase unless approved by the tenant of record and only them would purchases by sub-tenants be included; purchases of apartments leased to a Corporation or Partnership will be included if purchased by an individual approved by said Corporation or Partnership.

(b) A tenant is occupancy at the time of the offering shall have the exclusive right to purchase his apartment or the shares allocated thereto for ninety days after the offering, during which time his apartment shall not be shown to a third party unless he has, in writing, waived his right to purchase.

(e) Subsequent to the expiration of the 90 day exclusive right to purchase set forth in (b) above, a tenant in occupancy of a dwelling unit who has not purchased will be given the exclusive right for an additional period of six months from said expiration date to purchase said dwelling unit or shares allocated thereto on the same terms and conditions as contained in an executed contract to purchase made between the sponsor and a bona fide purchaser. The tenant must be given 15 days in which to exercise such right to purchase from the date of mailing by registered mail, of notification of the execution of a contract of sale, which notification shall contain a copy of said executed contract.

(d) For a period of one year after presentation of the Plan or until such time as the Plan is declared effective or until such time as tenant's lease has expired, whichever date is the latest, a tenant in occupancy shall be entitled to remain in possession without any increase in his rent, except as specified

in his existing lease. Thereafter, if he has not purchased he may be removed by the owner of the building, or the owner of the stock and lease allocated to his apartment.

(e) If the tenant's lease expires after the period during which he otherwise has the right to remain in possession, as hereinabove provided, he shall not be required to vacate his apartment until the expiration of his lease, unless such lease is terminated in accordance with this Code.

(f) If the Plan has not been declared effective within eighteen months from the date of the presentation of the Plan to the tenants, it will be declared abandoned, and, if the Plan is abandoned or is not declared effective within such eighteen month period, the tenants then in possession shall have the right to demand leases on the terms and conditions heretofore set forth in the law and regulations.

5. This Section 61 shall only apply to tenants in occupancy and lessees of record of vacant or subleased apartments at the time of the offering; it shall not be applicable or available to subtenants, or tenants leasing an apartment that was vacant at the time of presentation of the Plan.

6. Any dwelling unit which becomes vacant after the offering and prior to the transfer of the property to the cooperative corporation or the condominium owner, or a declaration of abandonment of the offering Plan, shall not be rented except at a rental which would have been authorized had the vacating tenant remained in prossession.

7. Notwithstanding anything contained herein to the contrary, any renewal or vacancy lease executed after notice to the HDA that a proposed cooperative or condominium Plan has been submitted to the Attorney General may contain a provision that the lease may be

cancelled after 90 days' notice to the tenant that the Plan has been declared effective. In any lease containing such a provision, upon submission of the Plan of cooperative or condominium ownership to the tenant after acceptance for filing by the Attorney General, no increase in rent may be collected thereafter pursuant to said lease. If the Plan is abandoned then rent will be at the rate set forth in said lease from the date of abandonment.

8. When the 35% requirement, provided in 4(a) above, has been met the owner will promptly notify all occupants and shall file a copy of the notice with the HDA along with an affidavit indicating the total number of apartments involved in computing the 35% and the names and apartments of the purchasing tenants.

Amendment to New York City Rent Stabilization Code, §61, In Effect on February 25, 1972

Section 61 is hereby amended by adding thereto a new subsection numbered 9, reading as follows:

9. (a) If after an offering Plan is presented to the tenants it is substantially amended prior to the transfer of title to the cooperative corporation, the time periods set forth in this Section 61 shall be extended, if applicable, from the date such amended offering Plan is presented to the tenants, as follows;

(i) If such date of presentation occurs during the ninety-day period provided under subsection 4(b), such period shall terminate not less than thirty days thereafter;

(ii) If such date of presentation occurs at any time after such ninety-day period under subsection 4(b) has expired, then for 30 days after such date a tenant in occupancy shall have the exclusive right to purchase on such amended terms, during which time his apartment shall not be shown to a third party unless he has, in writing, waived his right to purchase; followed by a period of 30 days or, if such date occurs during the six-months period provided

under subsection 4(c), by the balance of such six-months period, whichever is later, during which time the tenant shall have the rights provided under subsection 4(c);

(iii) The one-year period provided under subsection 4(d) shall in no even terminate less than six months after such date of presentation.

(b) "Substantial amendment" shall include but not be limited to: an increase or decrease in the mortgage amount or cash purchase price, an increase in the working capital or reserve fund, agreement by the Sponsor to make additional repairs or improvements, or to repurchase apartments, or the offer of new or better terms for financing the purchase price of an apartment.

(c) Nothing contained in this subsection 9 shall shorten any of the time periods in subsections 4(b), 4(c) or 4(d) but shall only extend the same, if applicable; nor shall anything contained in this subsection 9 extend the 18 month period provided in 4(f).

(d) This subsection 9 shall be effective only as to amendments accepted for filing by the Attorney General after January 31, 1972.

Rule 54, Federal Rules of Civil Procedure

* * *

(b) When more than one claim for relief is presented in an action, whether as a claim, counterclaim, cross-claim, or third-party claim, or when multiple parties are involved, the court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment. In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates

fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order or other form of decision is subject to revision at any time before entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

(c) *** [E]very final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings.

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(5635)

IN THE

Supreme Court of the United States

October Term, 1976

Supreme Court, U. S.
FILED
NOV 16 1976
MICHAEL RODAK, JR., CLERK

No. 76-541

MAX GRENADER, ROGER W. ACH II, ANN FIELDER, JOHN GERSTAD, LEE GERSTAD, CELIA GORDON, P. BENJAMIN KAUFMAN, DOROTHY KIMBALL, GERTRUDE LANDAU, HORACE MILLS, ADRIENNE MINASSIAN, SYLVIA JANE MORRISON, CORA MULLER-THYM, H. VICTOR SCHWIMMER, FRANCES STEIN, MARION TERRES, JOHN TERRES, MASIE G. WILKINSON, OLGA RUDNYANSKY, MADELINE SCHAINUCK,

Petitioners,

v.

MILTON SPITZ, HENRY SPITZ and JEROME SPITZ, d/b/a THREE FORTY FIVE MANAGEMENT CO., 34557 TENANTS CORP.,

Respondents,

and

BERNARD COOPER, ROBERT JULIUS, JERRY V. SHIELDS, JR., WILLIAM L. LIVINGSTONE, JOEL KEY RICE, FRANK MOORMAN, JUDITH ANN TAFT, GLORIA LISTER a/k/a GLORIA HAHN, SYLVIA SPITZ, ERNEST BORKLAND, JAMES DANIEL COTTON, BOBBY MITCHEL and S. MERCER MOORMAN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENTS IN OPPOSITION

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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-541

MAX GRENADER, *et al.*,
Petitioners,

v.

MILTON SPITZ, *et al.*,
Respondents,

and

BERNARD COOPER, *et al.*,
Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENTS IN OPPOSITION

Questions Presented

1. Are the principles established by this Court in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), applicable in determining whether "stock" in a

privately sponsored housing cooperative is a "security" for purposes of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act")?

2. Was the "economic reality" test as enunciated in *United Housing Foundation, Inc.* v. *Forman, supra,* correctly applied to the facts of this case?

Statement of the Case

This case involves the sale of cooperative apartments in a residential building located at 345 East 57th Street in New York City (the "Building"). The sales were made in accordance with applicable New York law,* which authorizes the conversion of a landlord-owned building into a tenant-owned cooperative housing corporation.

In 1971, the owners of the Building (the "Sponsor") converted it to cooperative ownership by selling the apartments therein to the individual tenants pursuant to a written offering plan which was duly filed with the Attorney General of the State of New York. The Offering Plan was principally devoted to a description of the real estate interests being conveyed and set forth the number of shares to which a purchaser had to subscribe in order to enter into a proprietary lease for the apartment. The Offering Plan specifically provided that the apartments would be sold solely for residential use and that the maintenance fees received from the respective owners would

* The New York State Syndication Act, McKinney's General Business Law, Section 352, *et seq.;* New York City Rent, Eviction and Rehabilitation Regulations, §55; and Code of the Real Estate Industry Stabilization Association of New York City, Inc., §61.

constitute the Cooperative's sole income.* The Offering Plan contained a description of the tenants' respective statutory rights, the Cooperative's by-laws, the proprietary lease and other pertinent materials. There were no representations of potential capital appreciation contained anywhere in the Plan.**

The Offering Plan, the proprietary lease and the subscription agreement demonstrate that the purchase of stock was completely tied to the lease of an apartment. The shares cannot be transferred to a non-tenant; a terminating tenant is required to relinquish his stock and the purchaser of the apartment must buy that stock; the shares are not transferable absent a sale of the apartment; and the shares cannot be pledged or hypothecated, other than as security for the purchase of the apartment. The proprietary lease delineated the tenant's rights and obligations and fixed the method for contributions by individual apartment owners to the cash needs of the Building. Upon breach of the proprietary lease, the Cooperative can terminate the tenant's right to occupy the apartment and may compel the return of the stock appurtenant thereto.

* The Offering Plan indicated that these receipts would be slightly augmented by rental income of approximately $180 per month from a laundry concession maintained in the basement for the tenants' convenience and by a 5% commission on gross receipts from tenants who subscribed to Manhattan Cable Television. There are no other commercial units on the premises.

** In the Offering Plan, the Sponsor also agreed to purchase the apartments of all non-purchasing tenants; prior to the closing it did so through its nominee, Eileen Dosik. The Sponsor continues to hold those apartments.

Argument

Petitioners* argue that Certiorari should be granted because the question of whether "stock" in a privately sponsored housing cooperative is a security within the ambit of the Federal securities laws** is of grave national importance and has never been decided by this Court. To the contrary, as discussed in Point I, *infra,* this Court's decision in *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. 837, is directly applicable here, and any decision by this Court in this case would necessarily be repetitive. Further, as discussed in Point II, *infra,* the Court of Appeals correctly applied the standards set forth in the *Forman* decision to the facts of this case.

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* Only two of the petitioners were actual purchasers of the "stock" at issue in this action. Thus, this action also presents the question of whether the remaining petitioners have standing under this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), an issue the Court of Appeals did not reach because of its decision that the "stock" here was not a security for purposes of the Federal securities laws.

** Petitioners would have this Court believe that, absent protection of the Federal securities laws, prospective purchasers of cooperative apartments will be without legal protection. This is simply untrue, as is evidenced by the proceedings brought by petitioners in the New York courts. They commenced an Article 78 Proceedings against the Attorney General of the State of New York and respondents herein in June, 1972 challenging the Attorney General's acceptance of the Plan and, in July, 1975, they commenced an action alleging common law fraud, based on the same allegations of omissions and misrepresentations alleged in this action.

I

The principles enunciated in *United Housing Foundation, Inc.* v. *Forman,* are applicable here.

Petitioners argue that the Court of Appeals erred by applying the principles set forth in *United Housing Foundation, Inc.* v. *Forman, supra,* a case involving a publicly sponsored housing cooperative, to the instant case, which involves a privately sponsored housing cooperative. They contend that the "scope of *Forman* does not extend to stock in . . . privately sponsored cooperatives." (Petition for Writ of Certiorari at p. 19*).

In *Forman,* this Court reiterated that, in determining whether a particular instrument is a "security", "form should be disregarded for substance and the emphasis should be on economic reality." 421 U.S. at 848 (citing *Tcherepnin* v. *Knight,* 389 U.S. 332, 336 (1967)). The factual situation before this Court in *Forman* involved a publicly sponsored housing cooperative. However, this decision cannot be limited to that particular factual situation, since it depended on the purpose and meaning of Congress' definition of the term "security". Indeed, this Court has held, under diverse factual situations, that the "economic realities" must be considered in determining whether there is a "security". *Tcherepnin* v. *Knight, supra; Securities and Exchange Commission* v. *W. J. Howey Co.,* 328 U.S. 293 (1946); *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.,* 320 U.S. 344 (1943). Applying this stand-

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* The Petition will hereinafter be cited to as "Pet." with the appropriate page reference following.

ard, this Court concluded in *Forman,* in language especially apt here:

> "There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial dealing. What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use." 421 U.S. at 858.

Petitioners argue that the "economic reality" analysis should not be applied here merely because this action involves a privately sponsored housing cooperative as opposed to the publicly sponsored cooperative at issue in *Forman.* The obvious impact of petitioners' argument is that the economic realities must be disregarded—a position completely contrary to all applicable case law.

II

The Court of Appeals properly applied the economic reality test to the facts of this case.

The Court of Appeals did not hold, as petitioners appear to suggest, that the *Forman* decision determined that "stock" in *all* privately sponsored housing cooperatives was not a "security". To the contrary, the Court of Appeals recognized that *Forman* requires a detailed analysis of the facts to determine whether there is a "securities transaction". Applying the criteria laid down in *Forman,* the Court of Appeals held that the shares of "stock" in this case were not "securities".

A. The Court of Appeals properly found that the cooperative apartments here were sold as residential housing for personal use.

This Court in *Forman* held that "when a purchaser is motivated by a desire to use or consume the item purchased —'to occupy the land or develop it themselves' . . . —the securities laws do not apply." 421 U.S. at 852-53. This Court then looked at the manner in which those cooperative apartments had been sold and concluded that "there can be no doubt that investors were attracted solely by the prospect of acquiring a place to live." 421 U.S. at 853.

Here, too, the Court of Appeals found that what had been sold was residential housing for personal use. 537 F.2d at 617. To arrive at that conclusion the Court of Appeals considered the Offering Plan, noting:

> "The content of the plan was principally devoted to the real estate interests being conveyed. The purchaser had to enter into a subscription agreement for the number of shares allocated to the unit in which he was interested, and was thereby entitled to a proprietary lease for his apartment. The apartments would be sold for residential use and the maintenance fees received from the respective owners would constitute the cooperative's income." 537 F.2d at 615.

The Court also determined that purchasers had not been enticed to purchase by promises of profit in the Offering Plan or anywhere else. As the Court of Appeals stated:

> "There is nothing in the record before us to support the contention that the investor here was attracted by the prospect of realizing a profit on his investment. While the court below found that the tenants were at-

tracted by the dual motives of obtaining housing and realizing a profit on their investments, the documentary evidence, which is all that was before the court, would indicate that the profit motive, if any, was purely incidental. The offering plan, which includes the subscription agreement, the proprietary lease and the by-laws is barren of any representation or intimation of anticipated profits. Unlike the hawking siren song of the promoter, the plan here is a prosaic recitation of the financial facts underlying the transaction with an exhaustive recitation of the physical properties and condition of the Building and the apartments offered as well as the terms of the tenancy and the obligations of the lessee. There is no reference to the possibility or probability of profits. In fact, there is ample warning that the annual maintenance charges set forth for each apartment (together with the purchase price of the shares fixed for each unit) are only estimates." 537 F.2d at 618-19.

Based on the facts contained in the record, the Court of Appeals concluded that the "transaction here essentially involves the acquisition of a residence". 537 F.2d at 618.

Petitioners now contend that the apartments at issue in this case were offered as investments (Pet. at pp. 13, 24-25).* This assertion does violence to the facts and was specifically found by the Court of Appeals to have no basis in the record. 537 F.2d at 618-19.

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* The petitioners argue that "most of the shares" purchased during the offering period were resold shortly after the initial offering (Pet. at p. 13). This fact is simply untrue and without any basis in the record.

B. The Court of Appeals properly found that the cooperative's "shares" did not otherwise have any of the characteristics of "securities".

The shares of stock involved here were found by the Court of Appeals to have no characteristics materially different from those found not to constitute a security in *Forman*. Petitioners argue that the shares of stock in this case differ from those in *Forman* in that they were "transferable" and "negotiable" (Pet. at pp. 24-25). In fact, the *Forman* shares and those at issue here are virtually identical. Here, as in *Forman*, the shares were non-negotiable "absent a sale of the apartment" and were completely tied to the apartment. 537 F.2d at 617.

Petitioners also argue that the "stock" here is a security because, unlike the shares in *Forman*, dividends may be declared on the shares (Pet. at pp. 9, 24-25). This contention was found by the Court of Appeals to be without factual support. As the Court of Appeals stated:

> "There is no affirmative provision for the payment of dividends in the transaction before us . . . The appellees argue that . . . . [Article III, §10 of the Cooperative's by-laws] implies that distribution[s] may be made out of earnings and profits. Under the economic reality test of *Forman*, it is indeed impossible to envisage what cash dividends would be reasonably anticipated from the operation of a cooperative residential housing venture. The only substantial income of the Corporation arises from the payment of rent or maintenance charges by the tenants, estimated on the basis of the cash requirements needed to operate the Building on an annual basis plus the creation of reserves for contingencies. Unlike *Forman*, there are no commercial tenants in the Building. Aside from rental income are

the fees realized from the coin-operated laundry and cable television which, of course, are tenant-financed and not significant. There is not a scintilla of evidence that any tenant was induced to become a purchaser of shares because he might expect to realize dividends. Whatever profit might be realized could only result in a reduction of the maintenance charged. Realistically, in view of continuously escalating labor, fuel and maintenance costs, all that a tenant could reasonably expect would be escalating monthly charges. The argument that a share purchaser was induced to acquire his apartment because of an opportunity to realize cash dividends is altogether frivolous." 537 F.2d at 617.

Petitioners further argue that the shares of stock in this case are materially different from those found in the *Forman* case not to be a "security" since tenants here receive one vote per share as opposed to the one vote per apartment in *Forman* (Pet. at pp. 9, 12-13). In fact, the tenant in this case votes based upon the size and location of his apartment; hence, as the Court of Appeals found, "the relationship of share purchase here to actual apartment residency is even more direct than in Co-op City, where the apartments were fungible as far as voting rights were concerned." 537 F.2d at 618.

Finally, petitioners argue that the stock here is different from the stock found in *Forman* not to be a "security" since it may be sold at a profit. The Court of Appeals, in applying the "economic reality" test, considered all of the facts, including the possibility that, due to the vagaries of the real estate market, the apartments might appreciate in value, and concluded that the apartments had been purchased as living quarters and not as an investment. 537 F.2d at 617-18.

In short, despite superficial differences between *Forman* and this case, the "economic realities" are the same and therefore the stock involved here, as the Court below properly held, is not a "security" within the purview of the Federal securities laws.

C. The Court of Appeals properly found that the cooperative's "shares" were not "investment contracts".

This Court in *Forman* also considered whether or not the cooperative apartments sold in that case were "investment contracts" as that term is defined in the Federal securities laws, although it found no distinction between a "security" and an "investment contract". In deciding that they were not, this Court looked for "the presence of an investment in a common venture premised on a *reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.*" 421 U.S. at 852 (emphasis added). This Court concluded that such expectations were not present since the purchasers in *Forman* had been attracted by the prospect of acquiring a residence and not by the "hope of receiving profits from the efforts of others." 421 U.S. at 858.

Petitioners here, like their counterparts in *Forman*, argue that these apartments are "investment contracts" (Pet. at pp. 22-26). The Court of Appeals rejected their argument, applying the same test utilized in *Forman*, and found that there was no evidence that the purchasers had been attracted by the prospect of realizing a profit. 527 F.2d at 618. To the contrary, the Court below found on the facts properly before it that the purchasers had ac-

quired their apartments for personal occupancy. 537 F.2d at 618.

Finally, the Court of Appeals also rejected petitioners' contention that any potential increase in value of a cooperative apartment resulted from the "efforts of . . . a third party". It observed that, while efficient management of a cooperative may enhance its desirability as a place to live, "it is hardly a factor which would result in the appreciation in value of the [Cooperative's] shares . . ." 537 F.2d at 619. Such appreciation, the Court concluded, "will depend upon the general housing market, the status of the neighborhood and the availability of credit." *Id.* at 619.

Conclusion

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

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